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Travel, Entertainment, and Gift Expenses

For use in preparing
1985 Returns

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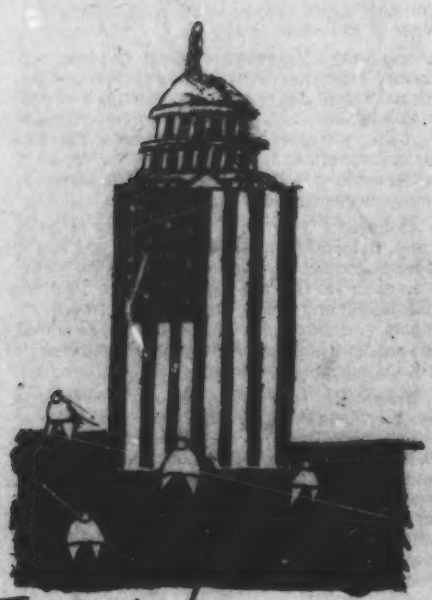

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Introduction

This publication explains business-related expenses for travel, transportation, entertainment, and gifts that you may deduct on your income tax return. It also discusses the reporting and recordkeeping requirements for these expenses.

Following a summary of the general requirements for deductibility by employees, self-employed persons (including independent contractors), and employers (including corporations and partnerships), the publication presents information on the rules governing these business expenses in terms of eligibility, proof, and reporting. Use the *Index* to help locate discussions of general topics that may apply to you.

Employees

If you are an employee and have travel, transportation, entertainment, and gift expenses related to your work, you may be able to deduct these expenses on your income tax return.

If you are not reimbursed for your travel, transportation, entertainment, or gift expenses that your job requires, you may deduct your travel and transportation expenses on line 25 of Form 1040, and your entertainment and gift expenses on line 22 of Schedule A (Form 1040). If you enter an amount on line 25 of Form 1040, attach Form 2106, *Employee Business Expenses*, to your return. You must keep records and supporting evidence to prove your expenses, as explained later under *Records*.

If you receive reimbursements or allowances for your expenses for travel, transportation, entertainment, or gifts, related to your work, you must include these payments on your income tax return unless you satisfy the rules under *How to Report*, later.

Amounts you spend for your employer for office expenses, local transportation for errands, and other incidental expenses for which you are reimbursed are not deductible. You do not have to report the reimbursement.

Outside salespersons, discussed later, do their selling away from their employer's place of business. If you are an outside salesperson, deduct these expenses on line 25 of Form 1040. Attach Form 2106 to your return. For more information, see *How to Report*, later.

Self-Employed Persons

If you are self-employed as a sole proprietor or independent contractor, deduct your own business travel, transportation, entertainment, and gift expenses on line 27 of Part II, Schedule C (Form 1040). Deduct your car expenses for travel and transportation on line 9 of Part II. The amounts you reimburse or allow your employees for these expenses are also reported on line 9 or line 27 of Schedule C.

Independent contractor. If you have travel, entertainment, or gift expenses on behalf of a client, you must prove these expenses. If you do not prove them you must include any reimbursements or allowances in income on line 4b of Part I, Schedule C (Form 1040).

Example. You are a lawyer and have a fee arrangement under which your client agrees to pay you back for all entertainment expenses you have on your client's behalf. You must satisfy all the rules in this publication to deduct the cost of this entertainment, unless you account to your client in enough detail to enable the client to prove the expenses. This is true even though the client may not deduct the expenses. You must keep copies of all the information you give to your client, because you may still be called on to prove the reimbursed expenses.

Client or customer. If you are a client or customer who in the course of your business reimburses or gives an allowance to an independent contractor for travel, entertainment, or gift expenses the contractor has on your behalf, the records you must keep will depend on whether the contractor accounts for and proves these expenses to you. If the contractor does account to you for these expenses, you also must account for and prove the expenses to be able to deduct them. You do not have to file an information return to report amounts paid to an independent contractor for travel expenses if the contractor accounted to you for these expenses.

If the contractor does not account to you for a reimbursement or allowance, then you do not have to account for the expense as a travel, entertainment, or gift expense. The amount would be deductible as a business expense if it was ordinary and necessary. However, if the contractor does not account to you for the travel expenses, you must file an information return (Form 1099–MISC) to report amounts paid to the independent contractor for travel expenses if the total of this reimbursement plus any other fees you paid for services is $600 or more.

Employers

You may deduct the amount you reimburse your employees. However, you should show on your return only your deductible expense account allowances for the year involved. For example, an accrual basis corporation gave an officer a $1,000 advance last year for this year's business expenses. The corporation will show the $1,000 as an expense account allowance on its return for this year.

Keeping records. If you require that your employees account to you, you must keep the records and supporting documents given to you by your employees to prove the deductions on your return for the allowances and reimbursements you paid them. Do not include these amounts on your employees' Forms W–2, *Wage and Tax Statement*. If you do not require proof from your employees, you must include the amount you paid them as a reimbursement in the amount shown in box 10 on Form W–2.

Withholding on per diem. You do not have to withhold income tax on advances or reimbursements you make to an employee for necessary travel and other expenses the employee has, or you expect the employee to have, in your business. When making a payment to an employee, either keep the reimbursements and wages separate or show the employee how much of the payment is for wages and how much is for reimbursement.

Nondeductible meals. You must report as other compensation in box 10 on Form W–2 payments you make to an employee for nondeductible meals an employee has on trips that do not require a stop for sleep or rest. You must report these payments on Form W–2 if these payments plus the employee's wages total $600 or more in a calendar year. You may report these payments on a separate Form W–2. You do not have to withhold income tax from these meal payments.

Car provided to employee. If you provide a car to an employee and allow any personal or commuting use of the car, you must report the value of this use as compensation in box 10 of the employee's Form W–2, and, if applicable, in box 13. Also, you must report the value to the employee in box 16. You may report the actual value of the personal use of the car for the calendar year, or you may report the value as if 100% of the use of the car by your employee for the calendar year is personal use. You may withhold income tax on the amount reported as the value of the car or you may choose not to.

However, you must withhold the applicable social security tax. For more information, see *Valuation and Taxation of Certain Fringe Benefits* in Chapter 2 of Publication 535, *Business Expenses*, and *Withholding on Taxable Noncash Fringe Benefits* in Publication 539, *Employment Taxes*.

A corporation generally deducts its expenses for business travel, entertainment, and gifts, including the amounts it reimburses or allows its employees for these expenses, on page 1 of Form 1120.

A corporate officer who claims a deduction for travel, transportation, entertainment, or gift expenses incurred on behalf of the corporation must be able to show that they were necessary expenses of the office.

Reimbursement to you by the corporation, or a resolution by the board of directors requiring that you assume such expenses, indicates that you had the expenses because you are an officer. The presence or absence of such evidence is not conclusive proof that you may deduct these expenses. If the expenses were primarily for your personal benefit, you may not deduct them and you must include any reimbursement in your income.

If your job requires that you travel and entertain for the corporation, and you are expected to pay the expenses without reimbursement, you may be able to deduct them. However, there should be a reasonable relationship between your expenses and your compensation.

A partnership deducts its expenses for business travel, transportation, entertainment, and gifts, including the amounts it reimburses or allows its employees for such expenses, on page 1 of Form 1065.

Proving Your Expenses

You must be able to prove all of your expenses if you claim a deduction for any of them. It is your responsibility to prove your deduction, even though it includes amounts that have been charged directly or indirectly to your employer. See *Records*, later.

Travel Expenses

Travel expenses are your ordinary and necessary expenses while traveling away from home for your business, profession, or job. You may deduct these expenses if you prove them, as explained later under *Records*. However, you may not deduct expenses that are lavish or extravagant or that are for personal or vacation purposes.

Travel expenses do not include expenses for transportation while not traveling away from home and expenses for entertainment. These are discussed later.

Deductible travel expenses include:

1) Air, rail, and bus fares,
2) Operating and maintaining your car,
3) Taxi fares or other costs of transportation between the airport or station and your hotel, from one customer to another, or from one place of business to another,
4) Transportation from the place where you eat and sleep to your temporary work assignment,
5) Baggage charges and transportation costs for sample and display material,
6) Meals and lodging when you are away from home on business,
7) Cleaning and laundry expenses,
8) Telephone and telegraph expenses,
9) Public stenographers' fees,
10) Operating and maintaining housetrailers,
11) Tips that are incidental to any of these expenses, and
12) Other similar expenses related to qualifying travel.

Business purpose. Your expenses must be for your travel or temporary living at some place other than your regular place of employment.

You are traveling away from home if your duties require you to be away from the general area of your tax home substantially longer than an ordinary day's work and, during your time off while away, you need to get sleep or rest to meet the demands of your work. This does not mean napping in your car. You do not have to be away from your tax home for a whole day or from dusk to dawn as long as your relief from duty is long enough to get necessary sleep or rest.

Example 1. You are a railroad conductor. You leave your home terminal on a regularly scheduled round-trip run between two cities and return home 16 hours later. During the run you have 6 hours off at your turnaround point where you eat two meals and rent a hotel room to get necessary sleep before starting the return trip. You are considered to be away from home.

Example 2. You are a truck driver. You leave your terminal and return later the same day. You get an hour off at your turnaround point to eat. Because you are not off to get necessary sleep and the brief time off is not an adequate rest period, you are not away from home.

Standard meal allowance. Instead of deducting the actual cost of your meals while you are traveling away from home for business, you may deduct $14 a day if you stay in one general area less than 30 days, or $9 a day if your stay is 30 days or more. You must still prove the actual cost of other travel expenses as well as the time, place, and business purpose of your travel (see *Accounting to Employer* and *Records*, later).

Brief incidental travel away from this general area, such as weekend trips home or for recreation, does not reduce the number of days you are considered to be in a general area.

On the day you begin or end your business travel you are allowed one-fourth of the $14 or $9 rate for each 6–hour quarter of the day during which you are either traveling or away from home. The 6–hour quarters are: midnight to 6 a.m.; 6 a.m. to noon; noon to 6 p.m.; and 6 p.m. to midnight.

Reimbursement. If you are reimbursed for your meal expenses while you are traveling away from home, you may use the standard meal allowance if:

1) You are reimbursed a separate amount for meals instead of receiving a combined allowance for both meals and lodging,
2) You reflect the reimbursement in your income, as discussed later under *How to Report*,
3) You are not required to provide proof to your employer for the actual amount of your meal expenses, and
4) You are not related to your employer. See *Related to your employer*, later.

If you use the standard meal allowance, you must use it to figure all your deductions for meal expenses during the year, except for reimbursed meal expenses that do not meet the requirements of the preceding paragraph. Use of the standard meal allowance is optional each year.

Example. You live and work in Los Angeles. Your employer sends you to San Francisco on a temporary assignment. Your employer reimburses you a separate amount for your meals. You leave home at 8 a.m. on March 19. Your assignment is completed on April 20. You arrive home at 4 p.m. of that day. You returned home each weekend. You are considered to be in the San Francisco area 32½ days (31 full days and 2 three-quarter days) because the four weekends you returned home do not reduce the number of days you are considered to be in San Francisco. You may only claim the $9 a day rate for this assignment.

However, you may not be able to deduct the full $9 a day for the time you were away from San Francisco on weekends. You may only deduct the lesser of what it cost to travel home or what it would have cost for meals (at $9 a day) and lodging if you had stayed in San Francisco. See *If you go home on your days off*, later.

Tax Home

Generally, your tax home is your main place of business or post of duty, regardless of where you maintain your family home. If you do not have a regular or main place of business because of the nature of your work, then your tax home is the place where you regularly live. If you do not fit either of these categories, you are considered an itinerant and your tax home is wherever you work. As an itinerant, you are not away from home and may not claim a travel expense deduction.

The entire city or general area in which your business or work is located is your tax home.

Two places of business or work. If you regularly work in two or more areas, your tax home is the general area where your main place of business or work is located.

Main place of business or work. You should use the following factors in determining your main place of business or work:

1) The total time you ordinarily spend working in each area,
2) The degree of your business activity in each area, and
3) The relative amount of your income from each area.

Example. You live in Cincinnati where you have a seasonal job for 8 months and earn $15,000. You work the remaining 4 months in Miami, also at a seasonal job, and earn $4,000. Cincinnati is your main place of work because you spend most of your time there and earn most of your income there.

Living away from your tax home. You may not deduct expenses for travel to and from and for meals and lodging you have in the area of your main place of work (tax home) when you maintain your family home in another area. You may be considered as traveling away from home while working in the same city in which you and your family live.

Example 1. You live with your family in Chicago, but work in Milwaukee, where you stay in a hotel and eat in restaurants during the week. You return to Chicago every weekend. You may not deduct any of your expenses for travel, meals, and lodging in Milwaukee, because that is your tax home and the travel on weekends is not for a business reason.

Example 2. Your family home is in Pittsburgh, where you work 12 weeks a year. The rest of the time you work for the same employer in Baltimore. In Baltimore you eat in restaurants and sleep in a rooming house. Your salary is the same whether you are in Pittsburgh or Baltimore. Because you spend most of your working time and earn most of your salary in Baltimore, that city is your tax home and you may not deduct any expenses you have for meals and

lodging there. However, when you return to work in Pittsburgh you are away from your tax home even though you stay at your family home. Therefore, you may deduct the cost of your round trip between Baltimore and Pittsburgh, and your part of your family living expenses for meals and lodging while you are living and working in Pittsburgh.

Temporary assignment or job. Although you regularly work or carry on your business activities within the city or general area of your home, you may have to work or conduct business at another location. It may not be practical to return home from this other location at the end of each day's work. If your assignment or job away from your regular place of work is temporary, that is, if its end can be foreseen within a fixed and reasonably short time, of usually less than one year, your tax home does not change. You are considered to be away from home for the whole period and your travel expenses are deductible.

An assignment or job expected to last for a year or more is considered indefinite and presumed not to be temporary. If an assignment or job is indefinite, you ***are not*** considered to be away from home and your travel expenses are not deductible. Under certain circumstances, you may overcome this one-year presumption if the assignment or job is expected to, and does, last for one year or longer, but less than 2 years. An expected or actual stay of 2 years or longer is considered an indefinite stay, regardless of the facts or circumstances.

You may overcome the one-year presumption by showing that you realistically expected the job to last less than 2 years and that you would return to your tax home after the job ends. In addition, you must show that your claimed tax home is your regular home in a real and substantial sense. Use the following three factors to see if your claimed tax home is your regular home:

1) You worked in the area of your claimed tax home immediately before your present job and you continue to have work contacts (job seeking, leave of absence, on-going business, etc.) in that area during your absence.
2) You have living expenses at your claimed tax home that you duplicate because your work requires you to be away from that home.
3) You have a member or members of your family living at your claimed tax home; or you continue to often use that home for lodging.

If your expectations that the job would last less than 2 years and that you would return to your tax home were realistic and you meet all three factors, you are temporarily away from home for travel expense deduction purposes. If you show that your expectations were realistic, but you meet only two of the factors, you may be temporarily away from home depending on the facts and circumstances. If your expectations were realistic but you do not meet at least two of the factors, you were not temporarily away from home and you may not deduct travel expenses.

Example. You are a construction worker. You live and regularly worked in Los Angeles. You are a member of a trade union in Los Angeles that helps you get work in the Los Angeles area. Because of a shortage of work you take a job on a construction project in Fresno. Your job was scheduled to end in 16 months and you planned to return to Los Angeles at that time. Your family continues to live in your home in Los Angeles. While in Fresno, you lived in a trailer you own. You returned to Los Angeles most weekends and maintained contact with the local union to see if you could get work in Los Angeles. Because you realistically expected the job in Fresno to last 16 months and to return home when it ended and you meet the three factors, your tax home is in Los Angeles for travel expense deduction purposes.

You may deduct the necessary travel expenses in first getting to your temporary assignment or job and in returning to your tax home after the assignment or job ends. Also, you may deduct your reasonable expenses for meals and lodging, even for days off, while you are at the temporary location.

If you go home on your days off, you are not away from home while you are in your home town. You may not deduct the cost of your meals and lodging there. However, you may deduct your travel expenses, including meals and lodging, from the area of your temporary place of work to your home town and return if they are no more than what it would have cost you for meals and lodging had you stayed at your temporary place of work. If they are more, your deduction is limited to the amount you would have spent at your temporary place of work. If you keep your hotel room while you are away, you may deduct your expenses of returning home only up to the amount you would have spent for meals had you stayed at your temporary place of work.

Indefinite assignment. If your job at the new location is for an indefinite time, that is, if its end cannot be foreseen within a fixed and reasonably short time, that location becomes your new tax home. See the previous discussion to see if your assignment is indefinite. You cannot deduct your travel, meals, and lodging expenses while there. You must include any amounts you receive from your employer for living expenses in your income, even if they are called travel allowances and you account to your employer for them.

You must determine whether your assignment is temporary or indefinite when you start work. A series of assignments to the same location, all for short periods but which together cover a long period, may be considered an indefinite assignment.

Probationary work period. If you take a job that requires you to move, with the understanding that you will keep the job if your work is satisfactory for a test period, the job is indefinite. You may not deduct any expenses for meals and lodging for the test period.

You may have a tax home even if you do not have a regular or main place of work. Your tax home may be the principal home where you regularly live. In such a situation, use the following three factors to see if you have a tax home:

1) You have part of your business in the area of your principal home and use that home for lodging while doing business there.
2) You have living expenses at your principal home that you duplicate because your business requires you to be away from that home.
3) You have not left the area in which both your traditional place of lodging and your principal home are located; you have a member or members of your family living at your principal home; or you often use that home for lodging.

If you meet all three factors, you have a tax home at the principal home where you regularly live and may have deductible travel expenses. If you meet only two of the factors, you may have a home depending on all the facts and circumstances. If you do not meet at least two of the factors, you are an itinerant and your home is wherever you work.

Example 1. You are an outside salesperson with a sales territory covering several states. Your employer has its main office in Denver, and you return there for about one month each year for business and nonbusiness reasons. Your business work assignments are temporary and you have no way of knowing where future assignments will be located. You have lived in Denver for 14 years, first with your spouse in your own house until your divorce, and then with your married sister in her house. You pay your sister $50 a month for a room in her house where you also keep your furniture and any clothing that you do not take on your out-of-town business trips.

You have met all three objective factors listed previously, including the traditional lodging aspects of factor (3), and therefore you have a home in Denver for travel expense deduction purposes.

Example 2. You are single and live in Boston in an apartment you rent. You have worked for your employer in Boston for a number of years. Your employer puts you in a 12–month executive training program. You do not expect to return to work in Boston after you complete your training. During your training you do not do any work in Boston. Instead you are given classroom and on-the-job training throughout the United States. You keep your apartment in Boston to which you return frequently. You use your apartment to conduct your personal business. You also keep up your community contacts in Boston. When you complete your training you are transferred to Los Angeles.

You have not satisfied factor (1) because you did not work in Boston. You have satisfied factor (2) because you have duplicate living expenses. You also satisfy factor (3) because you do not abandon Boston as your traditional home, you keep your community contacts, and you frequently return to live in your apartment. You have a home in Boston for travel expense deduction purposes.

Example 3. You are an outside salesperson with a sales territory covering several states. Your employer has its main office in Newark, but you do not go there for business reasons. Your work assignments are temporary, and you have no way of knowing where your future assignments will be located. You have a room in your married sister's house in Dayton. You stay there for one or two weekends a year but you do no work in the area. You have abandoned your traditional and family contacts in the area of Boston.

You have not met any of the objective factors listed. Therefore, you are an itinerant having your home wherever you work. Because you are not away from home, you may not deduct the cost of your meals and lodging as travel expenses.

Transient workers. If you move from job to job, maintain no fixed home, and are associated with no particular business locality, each place you work becomes your main place of business and your tax home. You may not deduct your expenses for meals and lodging.

New job. You may deduct amounts you spend for travel expenses, including meals and lodging, in looking for a new job in your present trade or business. You may not deduct these expenses if you are looking for work in a new trade or business or in looking for work for the first time. If you are unemployed, and there is a substantial break between the time of your past work and your looking for new work, you may not deduct these expenses, even if the new work is in the same trade or business as your last previous work.

If a prospective employer agrees in advance to give you an allowance or to reimburse you

for travel and transportation expenses in connection with a job interview, you must include in income the allowance or reimbursement that is more than your actual expenses.

If you move your home, you may qualify for a moving expense deduction if your new job location requires at least 35 miles additional commuting from your old home. You must also work full time in the new location for 39 weeks during the first 12 months after the move. For information, see Publication 521, *Moving Expenses*.

New business. You may not deduct amounts you spend for travel in conducting a general search for, or preliminary investigation of a new business. For more information, see *Going into Business* in Chapter 5 of Publication 334, *Tax Guide for Small Business*.

If you move your home because you acquire a new business, you may qualify for a moving expense deduction. For information on moving expenses, see Publication 521, *Moving Expenses*.

Travel in the United States

If your trip was entirely for business, you may deduct your ordinary and necessary travel expenses. If your trip was primarily personal, you may not deduct any travel expenses, even if you had some business activity at your destination.

If your trip was primarily for business and, while at your business destination, you extend your stay for vacation, make a nonbusiness side trip, or have other nonbusiness activities, you may deduct the travel expenses to and from your business destination.

Example. You work in Atlanta and make a business trip to New Orleans. On your way home, you stop in Mobile to visit your parents. You spend $450 for the 9 days you are away from home for travel, meals, lodging, and other travel expenses. If you had not stopped in Mobile, you would have been gone only 6 days and your total cost would have been $400. You may deduct $400 for your trip, including the round-trip transportation, to and from New Orleans.

If the trip was primarily for vacation, the entire cost of the trip is a nondeductible personal expense, except for any expenses incurred that are directly for and properly allocable to your business.

A trip can be a vacation even though a promoter advertises that a trip to a resort or on a cruise ship is primarily for business. The scheduling of incidental business activities during a trip, such as viewing video tapes or attending lectures dealing with general subjects, will not make what is intended to be a vacation into a business trip.

Whether the primary purpose of your trip was business or pleasure, you may deduct the expenses you had at your destination that were for your trade or business. If part of the trip is outside the United States, see *Travel Outside the United States*, later.

The United States includes the 50 states and the District of Columbia. Travel outside the United States does not include travel from one point in the United States to another point in the United States.

Public transportation. If you travel by public transportation, any place in the United States where that vehicle makes a scheduled stop is a point in the United States.

Example 1. You fly from New York to Puerto Rico, with a scheduled stop in Miami. You return to New York nonstop. The flight from New York to Miami is in the United States, so only the flight from Miami to Puerto Rico is outside the United States. The return trip is all outside the United States, as there are no scheduled stops between Puerto Rico and New York.

Example 2. You travel by train from New York to Montreal. The travel from New York to the last scheduled stop in the United States is travel in the United States.

Private car. Travel by private car in the United States is travel between points in the United States, even though you are on your way to a destination outside the United States.

Example. You travel by car from Denver to Mexico City and return. Your travel from Denver to the border and from the border to Denver is travel in the United States. You count the time only from when you cross the border until you recross the border on the return trip for applying the tests under *Travel Outside the United States*, later.

Private plane. If you travel by private plane, any trip, or part of a trip, for which both your takeoff and landing are in the United States is travel in the United States, even if part of your flight is over a foreign country.

Convention expenses. You may deduct travel expenses for yourself, not your family, to attend a convention if you can show that your attendance benefits your own work or business, as distinguished from the business or work of another. If the convention is for political, social, or other purposes unrelated to your work or business, you may not deduct the expenses. Nonbusiness expenses, such as social or sightseeing expenses, are personal expenses and are not deductible. Your appointment or election as a delegate does not, in itself, entitle you to, or deprive you of, the deduction. See *Foreign Conventions*, later.

Example. Your employer in Joplin, Mo., awarded you an expense-paid convention trip to Los Angeles for selling a certain amount of insurance. Your employer conducts no business in Los Angeles, and there was no educational or business reason for holding the convention there. During the 6-day convention, only one morning was devoted to a business meeting. You made several sightseeing trips. You must include the fair market value of the trip in your income because the company was rewarding you for your insurance sales. You may not deduct the cost of the trip because it was primarily for pleasure.

The agenda of the convention need not deal specifically with your official duties or the responsibilities of your position or business. It is enough if the agenda is so related to your business and its responsibilities that attendance for a business purpose is indicated.

Expenses paid by others. You may not deduct expenses paid by others or expenses you paid for your family members. You must reduce the expenses you pay by reimbursements or allowances received from others.

Expenses for your spouse. If your spouse goes with you on a business trip or to a business convention, you may not deduct the part of the expenses for travel, meals, and lodging for your spouse, unless you can prove a real business purpose for your spouse's presence. Incidental services, such as typing notes or assisting in entertaining customers, are not enough to warrant a deduction.

Example. You drive to Chicago on business and take your spouse with you. No business purpose is served by your spouse's presence. You pay $115 a day for a double room. A single room is $90 a day. You may deduct the total cost of driving your car to and from Chicago, but only $90 a day for your hotel room. If you use public transportation, you may only deduct your fare.

Travel for the government. You may deduct your travel expenses if you temporarily leave your regular place of business to advise or provide other services to the government but keep your regular business connection. Generally, you must include allowances and reimbursements on your tax return. See *How to Report*, later.

Members of the armed forces of the United States on permanent duty assignments overseas are not traveling away from home and may not deduct their expenses for meals and lodging, even if they are required to maintain homes in the United States for their families who are not allowed to accompany them. If you are transferred from one permanent duty station to another, see Publication 521.

Example. A naval officer assigned to permanent duty aboard a ship that has regular eating and living facilities has a home for travel expense purposes aboard ship.

Travel Outside the United States

If you travel outside the United States and the entire time is spent on business activities, you may deduct your travel expenses as if the travel had been entirely in the United States. Travel outside the United States does not include travel from one point in the United States to another point in the United States.

If your travel was primarily for business, but there were some nonbusiness activities, you may not be able to deduct all of your travel costs, including meals and lodging, while going from your home to your business destination and back. You may have to divide the expenses between business and nonbusiness activities.

If the travel was primarily for vacation and some time was spent attending brief professional seminars or a continuing education program, the entire cost of the trip is a nondeductible personal expense, except for registration fees and any other expenses incurred that are directly for and properly allocable to your business. If part of the trip is in the United States, see *Travel in the United States*, earlier.

Example 1. You are a doctor practicing medicine and are a member of a professional association. The association sponsored a 2-week trip to two foreign countries with three professional seminars in each country. Each seminar was 2 hours long and was held in a different city. You also made an optional side trip to a well-known tourist attraction in each of the countries visited. At the end of the trip you received a Certificate of Continuing Education in Medicine.

You paid the cost of air fare, hotel accommodations, meals, a special escort, transportation to and from hotels, and tips. No part of the cost was for the seminars, which were arranged for you by the sponsoring professional association.

Your participation in the professional seminars did not change what was essentially a vacation into a business trip. Your travel expenses were not related primarily to your business. You had no other expenses that were directly for your business. Therefore, you may not deduct your trip as an ordinary and necessary business expense.

Example 2. The university from which you graduated has a continuing education program for members of its alumni association. This program consists of trips to various foreign countries where academic exercises and conferences are set up to acquaint individuals in most occupations with selected facilities in several regions of the world. However, none of the conferences are directed toward specific

occupations or professions, and it is up to the initiative of each participant to seek out specialists and organizational settings appropriate to their occupational interests.

The stated aim of the program is to improve and enhance the human relations and professional skills required of individuals in their work settings. The objectives of the program include increased self-understanding, understanding of others, and increased awareness of the factors which promote or inhibit interpersonal effectiveness in business, professional, educational, and organizational settings.

Three-hour sessions are held each day over a 5-day period at each of the selected overseas facilities where participants can meet with individual practitioners. These sessions are composed of a variety of activities, including workshops, mini-lectures, role playing, skill development, and exercises. Professional conference directors schedule and conduct the sessions. Participants are free to choose those sessions they wish to attend.

You can participate in this program, since you are a member of the alumni association. You and your family take one of the trips. You spend about two hours at each of the planned sessions. The rest of the time you go touring and sightseeing with your family. The trip lasted less than 1 week.

Your travel expenses for the trip are not deductible, since the trip was primarily a vacation. However, registration fees and any other incidental expenses incurred by you for the five planned sessions you attended that are directly related and beneficial to your business are deductible business expenses. These expenses should be specifically stated to insure proper allocation of deductible business expenses.

Travel considered entirely for business. You may deduct your expenses for travel outside the United States using the same rules that apply to travel in the United States, if you meet any one of the following conditions.

1) You were an employee, were not related to your employer, were not a managing executive, and were reimbursed or received a travel expense allowance.

   Related to your employer is defined later under *Accounting to Employer*. A managing executive is an employee who because of executive authority and responsibility is authorized, not subject to the veto of another, to decide on the need for the business travel.

2) You had no substantial control over arranging the trip. You are not considered to have control merely because you have control over the timing of your trip.

   A self-employed person is generally regarded as having substantial control over arranging business trips.

3) You were outside the United States a week or less, combining business and nonbusiness activities. In counting the days, do not count the day you leave the United States, but count the day you return to the United States.

Example. You traveled to Paris primarily for business. You left Denver on Tuesday and flew to New York. On Wednesday you flew nonstop from New York to Paris, arriving the next morning. Thursday and Friday you had business discussions, and from Saturday until Tuesday you were sightseeing. You flew back to New York, arriving Wednesday afternoon. On Thursday you flew back to Denver. You were away from your home in Denver for more than a week. Because the day of departure from the United States does not count, you were not outside the United States for more than a week. You may deduct what it would have cost you to fly from Denver to Paris, conduct your business, and return to Denver. You may not deduct the cost of your stay in Paris from Saturday through Tuesday because it was not for business.

4) You spent less than 25% of the total time you were outside the United States in nonbusiness activities, even if the trip outside the United States was for more than a week. For this purpose, you count both the day your trip began and the day it ended.

Example. You flew from Seattle to Tokyo, where you spent 14 days on business and 5 days on personal matters, and then flew back to Seattle. You spent one day flying time in each direction. Because only 5/21 (less than 25%) of your total time abroad was for nonbusiness activities, you may deduct as your travel expenses what it would have cost you to make the trip if you had not engaged in any nonbusiness activity (the round-trip plane fare and 16 days of meals, lodging, etc.).

5) You can establish that a personal vacation was not a major consideration, even if you own your business, are related to your employer, are a managing executive, or have substantial control over arranging the trip.

How to divide. If you do not meet one of the five conditions listed above, you must divide your travel expenses on a day-to-day basis between the days you have business activities and days you do not have any business activities. Generally, you figure the amount of your travel expenses to and from your business destination that is not deductible by multiplying the total travel expenses by the total number of nonbusiness days, and dividing the result by the total number of days. You must count both the day of your departure from, and return to, the United States.

Transportation days are business days if you are traveling to or from a business destination. However, if, because of a nonbusiness activity, you do not travel by a direct route, your business days are the days it would take you to travel the most direct route without interruption to your business destination. Extra days for side trips or nonbusiness activities cannot be counted.

Presence required. Any day or part of a day that your presence is required at a particular place for a specific business purpose is counted as a business day.

If your principal activity during working hours is in pursuit of your trade or business, the day is counted as a business day. Any day you are prevented from working because of circumstances beyond your control is also counted as a business day.

Weekends, holidays, and other necessary standby days are counted as business days if they fall between business days. But if they are at the end of your business meetings or activity and you remain at your business destination for nonbusiness or personal reasons, they are not business days.

Example 1. While in Quebec, you had a full schedule of business activity through noon Friday. You had scheduled an appointment with a second client for Monday morning, but Thursday evening the client called and asked you to postpone your appointment until Tuesday. Because you had a business activity through noon Friday and had another business activity scheduled for Tuesday morning, the days in between are counted as business days, even though you use that time for sightseeing, personal visiting, or other nonbusiness activity.

Example 2. If, in Example 1, you had no other business in Quebec after Friday, but stayed until Tuesday before starting home, Saturday through Monday would be nonbusiness days.

If you had nonbusiness activity between the point you left the United States and your business destination, the amount of expense that you must divide between days of business activity and days of nonbusiness activity is what it would have cost you to travel, including meals and lodging, between the place where your travel outside the United States begins and the place of your nonbusiness activity, and return to the United States. Use the mode of travel you actually used.

Example. You live in New York and flew to Brussels on Monday, May 28, to attend a conference with a customer that began at noon Tuesday, May 29, and was over at noon Friday, June 1. That evening you flew to Dublin where you visited with friends until the afternoon of June 14, when you flew home to New York. The primary purpose for the trip was to attend the conference.

If you had not stopped in Dublin, you would have arrived home the evening of June 1. You were outside the United States more than a week, and you are unable to show that you had no substantial control over arranging the trip, or that a personal vacation was not a major consideration in making the trip. May 28 through June 1 (5 days) are business days and June 2 through June 14 (13 days) are nonbusiness days. You may not deduct your expenses while in Dublin and 13/18 of the cost of a round-trip airfare from New York to Dublin.

You may deduct the cost of your meals and lodging while in Brussels, to the extent they are not extravagant, all other necessary travel expenses while in Brussels (see *Deductible travel expenses include*, earlier), and the part of your round-trip transportation cost, including meals, from New York to Brussels, that is more than 13/18 of the round-trip plane fare between New York and Dublin. If the round-trip plane fare is $900 from New York to Brussels and $600 from New York to Dublin, you may deduct transportation costs of $366.67 [$900 − (13/18 × $600)].

If the nonbusiness activity was at or beyond your business destination, divide your total travel expenses, including meals and lodging, for traveling from the place where travel outside the United States began to the place of business activity and return to the United States.

Example. Assume in the example above that instead of going to Dublin for your vacation, you fly to Venice, Italy, for a vacation, and arrive back in New York on the evening of June 14. You may not deduct any part of the cost of your trip from Brussels to Venice and return to Brussels. In addition, you may not deduct 13/18 of the airfare from New York to Brussels and return. You may deduct 5/18 of the round-trip plane fare from New York to Brussels, plus your meals and lodging while in Brussels to the extent they are not extravagant, and any other business expenses you had in Brussels. If the round-trip plane fare is $800 from New York to Brussels, you may deduct transportation costs of $222.22 (5/18 × $800).

Other methods. If you establish that another method more clearly reflects the time spent outside the United States for nonbusiness activity, you can use it.

Foreign Conventions

You may not deduct expenses for attending a convention, seminar, or similar meeting held outside the North American area or Jamaica *unless* the meeting is directly related to your trade or business or income producing activity. It also must be as reasonable to hold the meeting outside the North American area or Ja-

meals as in it. If the meeting meets these requirements, you also must satisfy the rules for deducting expenses for business trips in general, discussed earlier under *Travel Outside the United States*.

North American area. The North American area includes the United States, its possessions, the Trust Territory of the Pacific Islands, Canada, and Mexico. For foreign conventions, U.S. possessions include Puerto Rico, Guam, and the U.S. Virgin Islands. The North American area may also include Bermuda and certain Caribbean countries. To qualify, certain requirements must be met and the country must be designated by the President as a beneficiary country. Beginning November 3, 1984, the North American area includes Barbados.

Jamaica includes the island of Jamaica, the Morant Cays, the Pedro Cays, and their dependencies.

Reasonableness. The factors to be taken into account to determine reasonableness are:

1) The purpose of the meeting and the activities taking place at the meeting,
2) The purposes and activities of the sponsoring organizations or groups,
3) The residences of the active members of the sponsoring organization and the places at which other meetings of the sponsoring organizations or groups have been or will be held, and
4) Other relevant factors you may present.

Cruise ship. You may deduct up to $2,000 of the expenses of attending a convention, seminar, or similar meeting held on a cruise ship if you establish that the meeting is directly related to your trade or business or income producing activity. A cruise ship is any vessel sailing inside or outside of United States waters.

You may deduct these expenses if—

1) The cruise ship is a vessel registered in the United States,
2) All of the cruise ship's ports of call are located in the United States or in possessions of the United States, and
3) You satisfy the reporting requirements below.

Reporting requirements. You must attach to your return—

1) A written statement you sign that includes—
   a) The total days of the trip, excluding the days of transportation to and from the cruise ship port,
   b) The number of hours each day that you devoted to scheduled business activities,
   c) A program of the scheduled business activities of the meeting, and
2) A written statement signed by an officer of the organization or group sponsoring the meeting that includes—
   a) A schedule of the business activities of each day of the meeting, and
   b) The number of hours you attended the scheduled business activities.

Reimbursing expenses. If you reimburse a person, whether or not your employee, for attending a convention, you may deduct the reimbursement if that person may deduct the convention expenses. If that person cannot deduct the expenses, the person must include the amount you pay in income. You may still deduct the amount you pay if you include it on an employee's Form W–2, *Wage and Tax Statement*, or in item 7 of a nonemployee's Form 1099–MISC, *Miscellaneous Income*. For information on Form W–2, see *Receipts for Employees and Form W–3* in Publication 539, *Employment Taxes*. For information on Form 1099–MISC, see *Form 1099–MISC* in Publication 916, *Information Returns*.

Transportation Expenses

Transportation expenses are the ordinary and necessary expenses of getting from one work place to another in the course of your business, profession, or job when you are *not* traveling away from home. Transportation expenses include the cost of travel by air, rail, bus, taxi, etc., and the cost of driving and maintaining your car, but *not* the cost of meals and lodging. Expenses for transportation while traveling away from home are deductible as travel expenses. For information on how to deduct transportation expenses, see *How to Report*, later.

Commuting expenses. You may not deduct the costs of taking a bus, trolley, subway, taxi, or car between your home and your main or regular place of work. These costs are nondeductible personal expenses. You may not deduct commuting expenses no matter what the distance is between your home and your regular place of work or if you are employed at different locations on different days within the same city or general area. You may not deduct commuting expenses even if you do work during the trip.

Example. You had a telephone installed in your car. You sometimes use that telephone to make business calls while commuting to and from work. Sometimes business associates ride with you to and from work and you have a business discussion in the car. These activities *do not change* the character of the trip from commuting to business. Your commuting expenses are not deductible.

Hauling tools or instruments in your vehicle in commuting to and from work does not make your commuting costs deductible. However, you may deduct additional costs, such as renting a trailer that is towed by your vehicle, for carrying equipment to and from your job.

Trips from a union hall, where you get your work assignments, to your place of work and parking fees at work are also nondeductible commuting expenses.

Example. You are a banquet waitress who works at several locations in your hometown area. Your union requires you to appear at the union hall to receive your work assignment for the day. You have parking expenses at the job.

Although you need the union in getting the job, you are employed where you work, not where the union hall is located. Therefore, you may not deduct the trips from your union hall to your place of work and parking fees at work.

Advertising display on car. The use of your car to display material that advertises your business does not convert personal use to business use. If you use this car for commuting or other personal use, your expenses for commuting and other personal use are not deductible.

Temporary or minor assignment. If you have a temporary or minor assignment beyond the general area of your tax home, and return home each evening, you can deduct the expenses of the daily round-trip transportation.

Two places of work. If you work at two places in a day, whether or not for the same employer, you may deduct the expense of getting from one place to the other. However, if for some personal reason you do not go directly from one location to the other, you may deduct only the amount it would have cost you to go directly from the first location to the second. Transportation expenses you have in going between home and a part-time Saturday job are commuting expenses. You may not deduct them.

Armed forces reservists. If your normal workweek is Monday through Friday and you attend a meeting of an armed forces reserve unit that meets one weekend a month in the general area of your tax home and you return to your home on Saturday night, the cost of transportation from your home to the reserve meetings is a commuting expense. You may not deduct it. If the meetings are held outside the general area of your tax home, you may deduct the cost of your transportation to attend the meetings. If the reserve meetings are held after work on a normal workday, the preceding paragraph applies.

Car Expenses

If you are required to use your car or light-duty truck in your business or work, you can take a deduction for car expenses. If you use your car exclusively in your business or work, you may deduct all of the cost of its operation. The deductible items include the costs of gas, oil, tires, repairs, insurance, depreciation, interest to buy the car, taxes, licenses, garage rent, parking fees, and tolls. Instead of figuring actual expenses, you may be able to use the standard mileage rate, discussed later.

If you use your car for both business and personal purposes, you must divide your expenses between business and personal use.

Example. You are a sales representative for a clothing firm and drive your car 20,000 miles during the year, 12,000 miles for business and 8,000 miles for personal use. You may only claim 60% (12,000/20,000) of the cost of operating your car as a business expense.

Certain nonbusiness car expenses are deductible if you itemize your deductions on Schedule A (Form 1040), even if you use your car entirely for personal purposes. These expenses are:

State and local personal property taxes (line 9),

State and local general sales taxes on motor vehicles (line 8b),

Interest on car loans (line 13), and

Certain casualty and theft losses (line 19).

Caution. If you have used your car partly for personal travel, and if you itemize your deductions, be sure that you list on Schedule A (Form 1040) only that part of the interest, taxes, etc., not claimed as travel or transportation expenses elsewhere on your return.

Car pools. You may not deduct the costs of repairs, gas, and similar items in driving a car in a car pool to and from work. Do not include payments from the passengers in income. These amounts are considered reimbursements of your expenses. However, if you are in a car pool for a profit, you must include these payments in income.

Fines and collateral for traffic violations are not deductible.

Car Placed in Service After June 18, 1984

Generally, if you place a car in service after June 18, 1984, and you use it in your work or business, there are limits on the amounts of section 179 deduction, investment credit, and depreciation you are allowed. These new rules do not apply to a car you place in service after June 18, 1984, but before 1985, if you acquired it under a contract that was binding on and after June 18, 1984. Also, new rules apply if you use your car (or other vehicle used as a means of transportation) 50% or less in your work or business. A vehicle used as a means of transportation is a truck or bus or any other vehicle, other than a car, used to transport persons or goods, except for a vehicle that is of a type ordinarily not susceptible to personal use.

Car defined. A car is any four-wheeled vehicle that is manufactured primarily for use on public streets, roads, and highways and that is rated at 6,000 pounds gross vehicle weight or less. A car includes any part, component, or other item that is physically attached to it and is traditionally included in the purchase price.

A car does not include:

1) An ambulance, hearse, or combination ambulance-hearse used directly in a business,
2) A vehicle used directly in the business of transporting persons or property for compensation or hire, and
3) A commuter highway vehicle that is eligible for the full investment credit. (See Publication 572, *Investment Credit.*)

Limits. For cars placed in service after June 18, 1984, and before April 3, 1985, the following limits apply. The investment credit for a car cannot be more than $1,000. The depreciation or recovery deduction, including the section 179 deduction, for a car cannot be more than $4,000 for the first tax year of the recovery period and $6,000 for each of the succeeding years. These limits also apply to a car placed in service after April 2, 1985, and before August 1, 1985, if you acquired it under a contract that was binding on and after April 1, 1985.

For cars placed in service after April 2, 1985, the following limits apply. The investment credit for a car cannot be more than $675. The depreciation or recovery deduction, including the section 179 deduction, for a car cannot be more than $3,200 for the first tax year of the recovery period and $4,800 for each of the succeeding years.

Section 179 deduction. If you use your car more than 50% for business or work, you may deduct as an expense part of the cost of the car. You must decide whether to deduct, subject to the limits, or capitalize and depreciate the car's cost. If you elect a deduction, a limited amount of the cost of a car you buy for use in your business or work is deductible in the year the car is placed in service.

Amounts to deduct. For cars placed in service after June 18, 1984, and before April 3, 1985, your total section 179 deduction and depreciation cannot be more than $4,000 for the tax year placed in service. This rule also applies to a car placed in service before August 1, 1985, if acquired under a binding contract in effect on and after April 1, 1985.

If the car is placed in service after April 2, 1985, your total section 179 deduction and depreciation cannot be more than $3,200.

These limits are further reduced if your business use of the car is more than 50% but less than 100%. For example, if you buy and place in service on May 2, 1985, a car that you use 80% for business, your total section 179 deduction and depreciation cannot be more than $2,560 (80% × $3,200).

For cars placed in service after June 18, 1984, that are not used more than 50% in a qualified business use, no section 179 deduction is allowed. See *Partial business use*, later.

Cost. The cost of the car for purposes of the section 179 deduction does not include that part of the basis of the car that is determined by reference to the basis of another car or any other property held by you at any time. For example, if you buy a new car to use in your business, your cost for purposes of the section 179 deduction does not include the adjusted basis of the car you trade in on the new vehicle.

If you use property for both business and nonbusiness, but more than 50% for business, you may elect the section 179 deduction. However, you must allocate the cost of the property to reflect only the business use of the property. Do this by multiplying the cost of the property by the percentage of business use. From this adjusted cost, you then may deduct up to the applicable amount.

When to elect. You must elect to take the section 179 deduction. You make this election in the tax year the car is placed in service. Employees use Form 2106, *Employee Business Expenses*, to make this election and report the section 179 deduction. All other taxpayers use Form 4562, *Depreciation and Amortization*, to make this election and report the section 179 deduction. You make the election by taking the deduction on the appropriate form filed with your original tax return. The election cannot be made on an amended tax return filed after the due date (including extensions), and once made, the election can be changed only with the consent of the Internal Revenue Service.

Basis of car. The amount you elect to deduct is subtracted from the basis of the car. This adjusted basis is the amount you use to figure your investment tax credit. If you elect the section 179 deduction, the amount of your depreciation deduction and your investment tax credit for the car will be reduced.

Recapture. You may have to increase your income by the amount of the section 179 deduction you took if your car is not used more than 50% in your business at any time before the end of the second tax year following the tax year you took the deduction. Use Form 4797, *Gains and Losses From Sales or Exchanges of Assets Used in a Trade or Business and Involuntary Conversions*, to report the recapture.

To figure the amount you include in income, subtract the depreciation that would have been allowed on the section 179 amount from the time the car was placed in service until the current year from the section 179 deduction you took for the car.

Dispositions. If you dispose of a car on which you claimed the section 179 deduction, the amount of the section 179 deduction you took is treated as a depreciation deduction for recapture purposes. Any gain on the disposition of the property is treated as ordinary income to the extent of the section 179 deduction and depreciation you took. For information on the disposition of property, see Publication 544, *Sales and Other Dispositions of Assets.*

Investment credit. If you acquire a car that you use more than 50% in your business or work and placed it in service in 1985, you may be able to take the investment tax credit. For cars placed in service after June 18, 1984, the investment credit is limited. For cars placed in service before April 3, 1985, the limit is $1,000, and if you elect the reduced investment credit, discussed later, it is limited to $666.67 (2/3 of $1,000). This limit also applies to cars placed in service before August 1, 1985, if acquired under a binding contract in effect on and after April 1, 1985. If a car is placed in service after April 2, 1985, the credit is limited to $675, and if you elect the reduced credit, it is limited to $450 (2/3 of $675).

These limits are further reduced if your business use of the car is more than 50% but less than 100%. For example, if you buy and place in service on May 2, 1985, a car that you use 80% for business, your investment credit cannot be more than $540 (80% × $675). If you elect the reduced investment credit, it cannot be more than $360 (80% × $450).

50% test. You cannot take the investment credit for a car unless more than 50% of your use of it in the year you place it in service is qualified business use. Qualified business use is discussed later under *Partial business use.* Use of an asset for the production of income, such as for investment activities, does not count for this 50% test. However, if you meet the more than 50% qualified business use test, you can count your other use of an asset for production of income when you figure your qualified investment in the asset.

Example. In 1985 you buy a car for use in your business. During 1985 you use the car 60% for a qualified business use and 20% for the production of income. Since you used the car more than 50% for qualified business use, you can take the investment credit. You figure the investment credit using the 80% combined business and investment use.

Improvements. If you add improvements to your car that qualify for the investment credit, your credit for these improvements cannot be more than the maximum allowable credit for the car minus the credit you have already taken on the car. Your total credit on your car and any improvements cannot be more than the appropriate limit.

Recapture. If you take the investment credit for your car and in a later year your combined use of it in your work or business and for the production of income falls to a lower percentage of total use for that year than for the year you placed the car in service, you are treated as having disposed of part of the car and you may have to recapture part of the credit. For example, if your combined use percentage is 80% in the year you place the car in service and in a later year this percentage falls to 60%, you are treated as having disposed of one-fourth of the car.

If the combined use percentage increases in a tax year after you place the car in service or after you have had to figure recapture on the car, you cannot take more investment credit. If your qualified business use percentage falls to 50% or less in any year, you are treated as having disposed of the entire car for purposes of figuring any recapture of the investment credit. See *Recapture of investment credit*, later.

Employee use. Use of a car by an employee in connection with the performance of services as an employee is not business use for figuring the employee's investment credit unless the employee's use of the car is for the convenience of the employer and is required as a condition of employment.

Figuring the investment credit. Use Form 3468, *Computation of Investment Credit*, to figure the investment credit on your car. Your investment credit for a car is 10% of your qualified investment in the car, but not more than the limits discussed earlier. If you use your car 100% for business and investment use and you take ACRS depreciation, discussed later, on the car, your qualified investment is usually 60% of your basis or cost of the car. But if you elect to take a reduced investment credit for your car, your qualified investment percentage is 40%. However, your qualified investment may be less. If you elect to take the section 179 deduction, you must subtract that amount from the cost of your car before you figure your investment credit. You cannot figure investment credit on the part of the cost of your car that you deduct as a section 179 deduction.

If you choose to use the standard mileage rate to figure your car expenses, you are considered to have made an election to exclude your car from ACRS depreciation. In this case your car can still qualify for the investment credit, but different rules apply for figuring the amount of your qualified investment. You must estimate a useful life in years to figure your qualified investment. If your car has a useful life shorter than 3 years, it does not qualify for the investment credit. If your car has a useful life of at least 3 years but less than 5 years, your qualified investment is one-third of its cost. Your qualified investment is two-thirds of the cost if the useful life is at least 5 years but less

than 7 years. If the useful life is 7 years or more, your qualified investment is the full cost of the car.

If you use your car partly for business and partly for personal purposes, but more than 50% for business, you can figure investment credit only on the part of the cost that is allocable to business and investment use.

Reduced credit. Generally, you must reduce the depreciable basis of your car by 50% of the investment credit you take. However, if you take ACRS depreciation on the car, you may elect to take a reduced investment credit instead of making the basis adjustment.

Recapture of investment credit. At the end of each tax year, you must determine whether you disposed of or stopped using in your business during the year a car for which you claimed investment credit in a prior year. If so, you may have to recapture some of the credit by adding it to your tax. Generally, the recapture increases your tax for the year. If you recapture the investment credit on a car of which the depreciable basis has been reduced, the depreciable basis of the car immediately before the event resulting in the recapture is increased by 50% of the amount of the recapture.

If you dispose of your car or it ceases to qualify for the investment credit before the end of the recapture period, you must recapture a percentage of the credit.

If your percentage of business use of the car falls below your percentage of business use for the year you placed the car in service, you may also have to recapture part of your investment credit.

The recapture period is the period of time after you place your car in service during which you must recapture a part of your investment credit if you dispose of the car or if it otherwise ceases to qualify as investment credit property. This period starts on the first day of the month you placed the car in service and, for a car that is depreciated using ACRS, continues for 3 full years after that day. For a car you elected to exclude from ACRS depreciation, the recapture period continues through the end of the useful life you used to figure your qualified investment.

You must determine a recapture percentage depending on the date, within the recapture period, of the event that causes the recapture. If you actually disposed of the entire car, use the date of disposition. If your percentage of business and investment use falls to a lower percentage of total use for a later year than for the year you placed the car in service, the date of the recapture event is the first day of that later tax year in which there is a decrease of business and investment use. The recapture percentages are in the instructions for Form 4255, *Recapture of Investment Credit.*

Use Form 4255 to report any investment credit recapture. To figure the recaptured credit if you disposed of the entire car, or are treated as having disposed of the entire car because business use fell to 50% or less, multiply the investment credit you took for the car by the recapture percentage. If you are treated as having disposed of only part of the car because of a decline in business use, figure the recaptured credit in two steps:

1) Determine the recapture percentage by multiplying the percentage from the Form 4255 instructions by the part of the car you are treated as having disposed of, then
2) Multiply the investment credit you took by this percentage.

Example. You are a calendar year taxpayer. On July 2, 1984, you bought a car for $20,000 and placed it in service. You used this car 80% for business in 1984. Because of the limit, your investment credit for this car was $800 (80% of $1,000). In 1985 you use the car only 60% for business. You are treated as having disposed of ¼ of the car as of January 1, 1985. Your business use for this part of the car was for less than a full year. You determine a recapture percentage of 25% (100% recapture percentage from the table in the Form 4255 instructions times ¼, the part of the car treated as having been disposed of). You must recapture $200 (25% of the $800 investment credit you took in 1984). You increase your unadjusted basis by $100 (50% of the $200 recapture amount) before you figure your depreciation for 1985. (See *Unadjusted basis*, later.) If you use the car 40% for business in 1986, you will be treated as having disposed of the rest of the car as of January 1, 1986. Since you will have used the car more than 50% for business for 1 full year, but less than 2 full years, you will recapture $396 (66% of $600) of the investment credit in 1986. You will increase your unadjusted basis by $198 (50% of $396).

Car traded. If you had previously taken the investment credit on a car and later traded it for a new car before the end of its recapture period, there will be a recapture of investment credit for the original car and an investment credit available for the new car in the year of the trade.

Depreciation. Unless you elect to exclude your car from ACRS depreciation, for example, by choosing to use the standard mileage rate to figure your car expenses for the year you acquire the car and place it in service, your car is 3-year recovery property. You figure your depreciation for it using the accelerated cost recovery system (ACRS). Employees use Form 2106 to figure their depreciation deductions. All other taxpayers use Form 4562.

Placed in service. A car is placed in service when it is available for use in your work or business, in the production of income, or in a personal activity. Depreciation begins when the car is ready for use in your work or business or for the production of income.

Accelerated cost recovery system (ACRS). Using ACRS, you recover the cost or other basis of your car over a 3-year recovery period unless you choose the alternate ACRS method. To figure your deduction under ACRS, multiply the unadjusted basis of your car by the applicable recovery percentage for the year. Your deduction does not change because you did not use your car for the full tax year. You may not deduct depreciation for the year you dispose of your car. Do not deduct salvage value when you figure your ACRS deduction.

The recovery percentages for cars are: 25% for the first year, 38% for the second year, and 37% for the third year.

Unadjusted basis. Unadjusted basis is the same amount you would use to figure gain on a sale not reduced for any depreciation but reduced by the amount you properly amortize or by the amount you elect to deduct as the section 179 deduction. If you buy the car, your unadjusted basis is usually its cost to you minus any section 179 deduction you elect. If you use your car only partly for business and the business use percentage changes from year to year, you will have to refigure your unadjusted basis each year. Do this by multiplying the cost of the car by the percentage of business use for the current year. From this result, subtract the section 179 deduction you took in the year you placed the car in service. You must also reduce your unadjusted basis by half of the investment credit you took in the year you placed the car in service, unless you took a reduced credit.

Trade in. If you trade in a car you used entirely in your business for another car that will be used entirely in your business, the unadjusted basis of the new car is the adjusted basis of the old car, plus any additional amount you pay for the new car.

Example. If you traded in a car that has an adjusted basis of $3,000 for another car, and in addition you pay cash of $7,000 for the new car, the unadjusted basis of the new car is $10,000 (the $3,000 adjusted basis of the old car plus the $7,000 cash paid). The unadjusted basis would be further modified if you claimed a section 179 deduction or if you did not choose to take a reduced investment credit.

If you trade in a car acquired after June 18, 1984, that you used partly in your business for a new car that you will use in your business, your basis for figuring depreciation deductions for the new car is the adjusted basis of the old car plus any additional amount you pay for the new car, reduced by the excess, if any, of:

1) The total of the amounts that would have been allowable as depreciation during the tax years before the trade if 100% of the use of the car had been business and investment use, over
2) The total of the amounts actually allowable as depreciation during those years.

Example. On July 2, 1984, you bought a car for $30,000 and placed it in service. During 1984 you used the car 80% for business. You did not elect the section 179 deduction for the car. You elected to take a reduced investment credit for the car. The maximum credit was $533.33 (the lesser of ⅔ of $1,000 × 80% or 80% × $30,000 × 40% × 10%). Your unadjusted basis in the car was $30,000. Your depreciation for 1984 was $3,200 (the lesser of 80% × $4,000 or 80% × $30,000 × 25%). On October 14, 1985, you trade in the car and pay an additional $1,000 for a new car. You cannot take a depreciation deduction in 1985 for the traded car and you have to recapture the investment credit. Your basis for figuring depreciation for the new car is $27,000 (the adjusted basis of $27,800 ($30,000 − $3,200 + $1,000) minus $800). The $800 is the excess of $4,000 (the deduction if the car had been used 100%) over $3,200 (the deduction allowable to you for 80% business use). You use the new car 80% for business in 1985. You do not elect the section 179 deduction for the new car. Your qualified investment in the new car for purposes of the investment credit is $27,800. The maximum investment credit is $540 (the lesser of 80% × $675 or 80% × $27,800 × 60% × 10%). Your unadjusted basis for ACRS is $26,730 ($27,000 − $270 (50% of the investment credit)). Your depreciation deduction for 1985 is limited to $2,560 (the lesser of 80% × $3,200 or 80% × $26,730 × 25%).

Reduction for investment credit. You may have to reduce the basis of your car by 50% of the amount of your investment credit. You make this reduction before you figure depreciation on the car. You may elect a reduced investment credit instead of a basis reduction. If you claim the reduced investment credit, you do not subtract 50% of the investment credit from the basis of the car.

Limits. For cars placed in service after June 18, 1984, the depreciation deduction is limited. If a car is leased after June 18, 1984, the amount of the rent paid or accrued is deducted in full but an amount must also be included in gross income, as explained later under *Leasing a Car.* The depreciation (recovery) deduction, including the section 179 deduction, for a car placed in service before April 3, 1985, may not be more than $4,000 for the first tax year of the recovery period and $6,000 for each of the suc-

ceeding tax years. This rule also applies to any car placed in service before August 1, 1985, if acquired under a binding contract in effect on and after April 1, 1985.

For cars placed in service after April 2, 1985, the depreciation deduction, including the section 179 deduction, may not be more than $3,200 for the first tax year of the recovery period and $4,800 for each of the succeeding tax years.

The section 179 deduction is treated as a depreciation deduction for purposes of the $4,000 or $3,200 limit in the tax year a car is placed in service. If you place a car in service in 1985 and elect the section 179 deduction, the section 179 deduction is treated as depreciation up to the $4,000 or $3,200 limit for the first year of the recovery period. For the remaining recovery years, the succeeding year's percentages are used to figure your ACRS deduction. The limit in the remaining recovery years is $6,000 or $4,800.

Percentage of business use. These limits are further reduced if your business use is less than 100%. Your depreciation deduction is also limited by the percentage of business use. This is the percentage of your total mileage during your tax year that you drove your car for business. If the percentage of business use changes, your depreciation deduction changes because the basis for figuring depreciation changes.

Deductions in years after the recovery period. If, at the end of the recovery period, you have any unrecovered basis in your car and you continue to use it in your work or business, you can claim a deduction, limited to $6,000 or $4,800, for each tax year until you recover your basis in the car.

If you choose to use the alternate ACRS method or must use the straight line method for your car, the recovery period extends 1 year beyond the period used, because of the half-year convention. For example, you are a calendar year taxpayer, you place a car in service on September 10, 1985, and you elect the alternate ACRS method over 5 years. The recovery period is treated for purposes of the limits as lasting to the end of the 6th year. The determination of the unrecovered basis is not necessary until the beginning of the 7th year after the car is placed in service.

A deduction in a year after the recovery period that is based on the unrecovered basis is allowable only to the extent that a deduction for depreciation would be allowable for that year. For example, no deduction is allowable for a year you dispose of your car or use it 100% for personal purposes.

Unrecovered basis is the unadjusted basis of the car, not reduced by any section 179 deduction you took, minus the depreciation deductions, including any section 179 deduction you took, that would have been allowable if you had used the car 100% for business and investment use. To figure unrecovered basis, depreciation deductions for earlier tax years are figured as if the car had been used 100% for business and investment use in the earlier tax years, beginning with the first tax year in which some or all of the use of the property was for business and investment use. When depreciation deductions for earlier tax years must be figured as if the car was used 100% for business and investment use, those deductions are subject to the limits discussed earlier.

Example 1. On July 1, 1984, you bought for $25,500 and placed in service a car you use 100% in your business during tax years 1984 through 1988. You did not take the section 179 deduction. The maximum amount of investment credit for the car was $1,000 (the lesser of $1,000 or 6% of $25,500). Your unadjusted basis for depreciation is $25,000 ($25,500 − $500, 50% of the $1,000 investment credit). The maximum amount of depreciation for 1984 was $4,000 (the lesser of $4,000 or 25% of $25,000). Your depreciation for 1985 is $6,000 (the lesser of $6,000 or 38% of $25,000) and for 1986 it will be $6,000 (the lesser of $6,000 or 37% of $25,000). At the beginning of 1987, you will have an unrecovered basis in the car of $9,000 ($25,000 unadjusted basis − $16,000 total depreciation allowed). Although the 3-year recovery period for the car will have expired, if you continue to use the car 100% in your business during tax years 1987 and 1988, you may claim $6,000 as depreciation in 1987 and $3,000 (unrecovered basis at the beginning of 1988) as depreciation in 1988.

Example 2. Assume the same facts as in Example 1 except that you took a $4,000 section 179 deduction for the car in 1984. The maximum amount of depreciation and section 179 deduction you could deduct for the car in 1984 was $4,000. Your investment credit for the car was $1,000. Your unadjusted basis for depreciation is $21,000 ($25,500 − $4,000 − $500). In 1985 your depreciation deduction for the car is $6,000 (the lesser of $6,000 or 38% of $21,000). In 1986 your depreciation deduction for the car will be $6,000 (the lesser of $6,000 or 37% of $21,000). At the beginning of 1987, you will have an unrecovered basis in the car of $9,000 ($25,000 unadjusted basis for this purpose − $16,000 total depreciation allowed). If you continue to use the car for business, you may claim $6,000 in 1987 and $3,000 in 1988 as depreciation on the car.

Alternate method. If you choose, you may use an alternate method of figuring your depreciation under ACRS. This method is based on the straight line method of depreciation and is used in place of the recovery percentages discussed earlier. Under this method, you may choose a recovery period of either 3, 5, or 12 years for all cars you place in service during the tax year. The straight line recovery percentage for 3 years is 33.333%, 5 years is 20%, and 12 years is 8.333%.

The first year the car is placed in service you deduct half the amount of the depreciation that would be allowed for a full year. It does not matter when during the year you first begin using the car. If you use the car in your business for the entire recovery period you choose, you also deduct half the amount of a full year's depreciation in the tax year after the end of the recovery period. For the tax years in between you deduct the full amount of depreciation.

Example. You buy a car for $12,000 on January 5, 1985, that you use 100% for business through 1989. You do not take the section 179 deduction, but you do take the reduced investment credit. You choose a 5-year recovery period. The recovery percentage is 20%. Your recovery deduction for 1985 and 1990 is $1,200 ($12,000 × 20% × ½). Your deduction for each of the years 1986 through 1989 is $2,400 ($12,000 × 20%). You will recover your cost in 1990.

Short tax year. The limit for depreciation in a short tax year (tax year of less than 12 months) is determined by multiplying the limit that would be applicable to the tax year if it were not a short tax year by a fraction, the numerator (top number) of which is the number of months or part months in the short tax year and the denominator (bottom number) of which is 12. For example, if you use your car 60% for business in a short tax year consisting of 6 months, the maximum amount you may claim as depreciation is 30% (60% × 6/12) of the applicable limit.

Improvements. An improvement to a car that is a capital item is treated as a new item of recovery property placed in service in the year the improvement is made. The limits on the depreciation deductions are determined by taking into account as a whole both the improvement and the car of which the improvement is a part. Your total depreciation deduction for the year on your car and any improvements cannot be more than the appropriate limit.

Disposition of a car. If you dispose of your car or no longer use it in your work or business, you get no depreciation deduction for the tax year you dispose of it or stop using it in your work or business, unless you elected to exclude your car from ACRS depreciation.

Business use of car more than 50% but less than 100%. If you place a car in service after June 18, 1984, and you use it less than 100% but more than 50% in your business or work, you determine the investment credit and depreciation deduction limits by multiplying the limit amount by the percentage of business and investment use during the tax year.

Example. On October 1, 1985, you buy a car and place it in service. You use it 80% in your business during 1985. The maximum amount of investment credit for the car is $540 (80% of $675). If you elect the reduced investment credit instead of a basis reduction for the car, the credit would be limited to $360 (80% of $450). Your total depreciation deduction for 1985 is limited to $2,560 (80% of $3,200). If the business use of the car remained at 80%, your deduction in 1986 and 1987 (second and third year of the recovery period) would be limited each year to $3,840 (80% of $4,800). If you had an unrecovered basis at the beginning of 1988, your deduction for 1988 would also be limited to $3,840 (80% of $4,800).

Partial business use. You cannot take the investment credit or the section 179 deduction, and you must figure depreciation using the straight line method over a 5-year period, if you use your car (or other vehicle) 50% or less in a qualified business use. If you used your car more than 50% in a qualified business use in the year you placed it in service, but 50% or less in a qualified business use in a later year, you may have to recapture the investment credit and any excess depreciation. Any excess depreciation must be included in gross income and added to your car's adjusted basis for the first tax year in which the car is used 50% or less in a qualified business use.

If you are required to use the 5-year recovery period for a car not used more than 50% in a trade or business, use 10% as the recovery percentage for the 1st and 6th years and 20% for the 2nd through the 5th years.

Qualified business use. A qualified business use is any use in your trade or business. Qualified business use does not include use of property held merely for the production of income (investment use).

Investment use. The use of a car in connection with the production of income is not a qualified business use. Whether the investment credit and the regular ACRS percentages are available for the car is determined by reference to the qualified business use (use in a trade or business) rather than by reference to business and investment use.

Employee use of car. If you are an employee and use your own car (or other vehicle) in your work, you cannot take the investment credit or a deduction for ACRS depreciation unless this use is for the convenience of your employer and is required as a condition of employment.

Whether the use of your car is for the convenience of your employer must be determined from all the facts. The use is regarded as for your employer's convenience if the use is for a substantial business reason of your employer. The use of your car during your regular work-

ing hours in carrying on your employer's business generally is considered to be for the convenience of your employer.

Whether the use of your car is required as a condition of employment depends on all the facts and circumstances. The use of your car must be required for you to perform your assigned duties properly. Your employer does not have to require explicitly that you use your car. Also, a mere statement by your employer that the use of your car is required as a condition of employment is not sufficient.

Use of your car by another person. Any use of your car by another person is not treated as use in a trade or business unless that use:

1) Is directly connected with your business,
2) Is properly reported by you as income to the other person and, if required, you withhold tax on the income, or
3) Results in a payment of fair market rent.

Any payment to you for the use of the car is treated as a payment of rent for purposes of (3) above.

More than 50% use test. You meet this test if you use your car more than 50% in a qualified business use for any tax year. You must allocate the use of your car that you use for more than one purpose during the tax year to the various uses. The percentage of investment use is not part of the percentage of qualified business use for purposes of the more than 50% test. However, the combined total business and investment use is taken into account to figure the depreciation deductions for the property. Property does not cease to be used more than 50% in a qualified business use by reason of a transfer at death.

For your car (or other vehicle), allocate the use on the basis of mileage. The percentage of qualified business use is determined by dividing the number of miles you drive your car for business purposes during the year by the total number of miles you drive your car during the year for any purpose.

Meeting the more than 50% use test. You must meet the more than 50% use test each year of the recovery period for your car. For example, if you place a car in service after June 18, 1984, you must apply the more than 50% use test to that car each year for 6 recovery years.

First recovery year. If a car is not used more than 50% in a qualified business use in the year it is placed in service, the depreciation deduction is figured using the percentages given earlier. In addition, no section 179 deduction is allowable for the property.

Years after the first recovery year. If you use your car more than 50% in a qualified business use in the tax year the property is placed in service but not in a subsequent tax year during the 6-year recovery period, you must determine your depreciation for that property using the percentages given earlier. You determine your depreciation for the tax year and any subsequent tax years as if the car had not been used more than 50% in a qualified business use in the year in which it was placed in service.

Excess depreciation. Any excess depreciation must be included in gross income and added to the car's adjusted basis for the first tax year in which the car is not used more than 50% in a qualified business use. Excess depreciation is the excess, if any, of:

1) The amount of the depreciation deductions allowable (including any section 179 deduction elected) for the car for tax years before the first tax year in which the car was not used more than 50% in a qualified business use, over
2) The amount of the depreciation deductions that would have been allowable for those years if the car had not been used more than 50% in a qualified business use for the year it was placed in service.

Example. On June 25, 1984, you bought a car for $11,000 and placed it in service. You did not elect the section 179 deduction but you did elect a reduced investment credit instead of a basis reduction. You use the car exclusively in a qualified business use for 1984, 1985, and 1986. Using the regular ACRS percentages for 3-year property, since this gives lower recovery deductions than the *Limits* discussed earlier, you recover your cost in full. During 1987 you use the car 50% for business and 50% for personal purposes. You must include in gross income for 1987 your excess depreciation determined as follows:

Total depreciation claimed		$11,000
Total depreciation allowable		
1984—10% of $11,000	$1,100	
1985—20% of $11,000	2,200	
1986—20% of $11,000	2,200	5,500
Excess depreciation		$5,500

In 1987 you must include $5,500 in gross income. Your adjusted basis for the car is also increased by $5,500. Your 1987 depreciation deduction is $1,100 (20% (4th year percentage) × $11,000 (unadjusted basis) × 50% (business use percentage)).

For more information on depreciation and the section 179 deduction, see Publication 534, *Depreciation.* For more information on investment credit, see Publication 572, *Investment Credit.*

Change from personal to business use. If you change the use of a car from 100% personal use to business use during the tax year, and you have no records for the time before the change to business use, you determine the percent of business use for the year as follows:

1) Determine the percent of business use for the period following the change by dividing business miles by total miles driven during the period.
2) Multiply that percentage by a fraction, the numerator (top number) of which is the number of months the car is used for business and the denominator (bottom number) of which is 12.

Example. You use a car only for personal purposes for the first 6 months of the year. During the remaining 6 months of the year you drive the car a total of 15,000 miles of which 12,000 miles were for business for a business use percentage of 80%. Your business use for the year is 40% (80% × 6/12).

Car provided by employer. If your employer provides you with a car and allows any commuting or other personal use of the car, you have received a noncash fringe benefit. (See Publication 525, *Taxable and Nontaxable Income,* for information on fringe benefits.) Your employer will include the value of this fringe benefit in the compensation shown on your Form W–2. Your employer may include on your Form W–2 either the actual value for the calendar year of your personal use of the car or the value for the calendar year determined as if your entire use of the car for the year is personal use (100% of value included in income).

Actual value of personal use included in income. If your employer includes in your compensation on Form W–2 the actual value of your commuting and other personal use of the car, this amount is income you must report on the wages line of your income tax return. In this situation, you are considered to be reimbursed an amount equal to your car expenses and you have no car expense deduction on Form 2106 for use of the employer-provided car. If, based on the facts and circumstances, you disagree with the amount your employer included in your compensation on Form W–2 for use of an employer-provided car, you adjust the amount you show on the wages line of your tax return and attach a statement explaining how you figured the amount shown. Write "FB" in the margin to the left of the wages line of your tax return. See *Different valuation by employer and employee* in Publication 525.

100% of value included in income. If your employer includes in your compensation on Form W–2 100% of the value of the car, you can take a car expense deduction on Form 2106 for your business use of the employer-provided car. You figure your car expenses in Section C, Part II of Form 2106. You ***cannot*** use the standard mileage rate for an employer-provided car since you do not own the car. You enter the value of the car that is included on your Form W–2 on line 18, Section C, Part II of Form 2106.

If your Employer uses the special accounting rule, you must use it for the same period. You may not use the special accounting rule, however, unless your employer uses it. Under the special accounting rule, your employer may treat the value of a car provided during the last 2 months of the calendar year, or any shorter period, as paid in the next year. Thus, the value of a car provided January 1, 1985, through October 31, 1985, would be treated as provided in 1985. For years after 1985, the value of the car for the last 2 months of a calendar year is treated as provided in the next year together with the value of a car provided in the first 10 months of the next year. You must figure your expense deduction on Form 2106 in the same way.

Records. You must substantiate your use of a car provided by your employer in the same way that you substantiate the use of your own car for business. See *Records,* later.

Car Placed In Service Before June 19, 1984

The following rules apply to a car you use in your work or business that you placed in service before June 19, 1984 (or that you placed in service after June 18, 1984, but before 1985, if you acquired the car under a contract that was binding on and after June 18, 1984).

Section 179 deduction. If you took the section 179 deduction for a car you use in your work or business, you cannot change your choice unless you get permission from the Internal Revenue Service. You must depreciate the car under the accelerated cost recovery system (ACRS), discussed later. Therefore, you cannot use the standard mileage rate to figure your deductible expenses. You also may not take a depreciation deduction for the part of the cost you deducted.

Recapture. You may have to increase your income by the amount of the section 179 deduction you took if your car is not used more than 50% in your business at any time before the end of the 2nd tax year following the tax year you took the deduction. Use Form 4797, *Gains and Losses From Sales or Exchanges of Assets Used in a Trade or Business and Involuntary Conversions,* to report the recapture.

To figure the amount you include in income, subtract the depreciation that would have been allowed on the section 179 amount from the time the car was placed in service until the current year from the section 179 deduction you took for the car.

If you dispose of property on which you claimed the section 179 deduction, the amount of the section 179 deduction you took is treated

as an ACRS deduction for recapture purposes. Any gain on the disposition of the property is treated as ordinary income to the extent of the section 179 deduction and depreciation you took. For information on the disposition of property, see Publication 544, *Sales and Other Dispositions of Assets.*

Investment credit recapture. If you took the investment credit for a car or light-duty truck you bought and placed in service in your work or business, you may have to repay part of the investment credit if you dispose of the car or truck before the end of the recovery period or useful life used to figure your qualified investment. You are considered to have disposed of your car if you discontinue using it in your business. Use Form 4255, *Recapture of Investment Credit,* to report any investment credit recapture.

To figure the recaptured credit, multiply the original investment credit you took for the car by recapture percentage. The result is the amount of the recapture. The recapture percentages are in the instructions for Form 4255. Generally, the recapture amount increases your tax for the year.

For more information on the investment credit recapture, see Publication 572.

Depreciation. How you figure your depreciation deduction depends on when you first place your car in service. If you first place your car in service after 1980, figure your depreciation deduction using the accelerated cost recovery system (ACRS), discussed later. If you first placed your car in service before 1981, use the same rules for figuring depreciation in 1985 that you used in prior years, unless the car is fully depreciated. If you use your car only for personal purposes before 1981 and first use it in your business after 1980, you may not use ACRS. However, if you acquire a car after 1980 for personal use and begin using it for business in a later year, you must use ACRS, unless you use the standard mileage rate, discussed later. Use Form 4562, *Depreciation and Amortization,* to figure your depreciation deduction. See the earlier discussion under *Car Placed in Service After June 18, 1984,* for limits on depreciation of a car placed in service after June 18, 1984.

Placed in service. A car is placed in service when it is available for use in a trade or business, in the production of income, or in a personal activity. Depreciation begins when the car is ready for use in a trade or business or for the production of income.

Percentage of business use. Your depreciation deduction is limited by the percentage of business use. This is the percentage of your total mileage during your tax year that you drove your car for business. If the percentage of business use changes, your depreciation deduction changes because the basis for figuring depreciation changes.

Accelerated cost recovery system (ACRS). Figure your depreciation deduction using ACRS for a car you first place in service after 1980. You recover your cost or other basis over a 3-year recovery period unless you select the alternate ACRS method. To find your deduction under ACRS, multiply the unadjusted basis of your car by the applicable recovery percentage for the year. You may not deduct depreciation in 1985 if you sell the car during the year. Do not subtract salvage value when you figure your ACRS deduction.

Unadjusted basis is the same amount you would use to figure gain on a sale with no adjustments for any depreciation. This is generally your cost if you buy a new car. However, if you deduct part of the cost of a car as a section 179 deduction, reduce your unadjusted basis by the amount of your section 179 deduction. If you take the deduction and the car is used only partly in your business, you have to refigure your unadjusted basis each year. Do this by multiplying the cost of the car by the percentage of business use for the current year. From this result, subtract the section 179 deduction you took in the first year. For a car first placed in service after 1982, you must also reduce your unadjusted basis each year by half of the investment credit you took, unless you took a reduced credit.

The recovery percentage for cars or light-duty trucks first used in business after 1980 is:

Year	Percent
First	25
Second	38
Third	37

Multiply the unadjusted basis of the car by the stated recovery percentage for the year to find your depreciation. Your deduction does not change because you did not use your car for the full tax year.

Example 1. You bought a car for $12,000 on June 5, 1984, that you used 100% in your business in 1984. You did not take a section 179 deduction, but you did take a reduced investment credit. You deducted depreciation of $3,000 ($12,000 × 25%) for 1984. You use this car 100% in your business in 1985. Your depreciation deduction is $4,560 ($12,000 × 38%) for 1985. If you use this car 100% in your business in 1986, your depreciation deduction will be $4,440 ($12,000 × 37%) for 1986. You will recover your cost in 1986. If you sell this car in 1985, you do not get a deduction after 1984.

Example 2. In Example 1, you chose to take $5,000 of the cost as a section 179 deduction in 1984. You also chose to take a reduced investment credit. Your unadjusted basis for figuring depreciation is $7,000 ($12,000 − $5,000). Your depreciation deduction is $1,750 ($7,000 × 25%) for 1984, $2,660 ($7,000 × 38%) for 1985, and $2,590 ($7,000 × 37%) for 1986.

Example 3. In Example 2 you used your car 70% in your business in 1984, 75% in 1985, and 80% in 1986. The cost of your car (unadjusted basis) attributable to business use in 1984 was $8,400 ($12,000 × 70%) and your section 179 deduction for 1984 was $5,000. Because you deducted the $5,000, your depreciation deduction in 1984 was $850 [($8,400 − $5,000) × 25%]. The cost of your car attributable to business use in 1985 is $9,000 ($12,000 × 75%). Because you expensed $5,000 in 1984, the remaining cost attributable to business use in 1985 is $4,000 ($9,000 − $5,000) and your depreciation deduction in 1985 is $1,520 ($4,000 × 38%). Similarly, the cost of your car attributable to business use in 1986 will be $9,600 ($12,000 × 80%). The remaining cost attributable to business use in 1986 will be $4,600 ($9,600 − $5,000) and your depreciation deduction in 1986 will be $1,702 ($4,600 × 37%).

Alternate method. If you choose, you may use an alternate method of figuring your depreciation under ACRS. This method is based on the straight line method of depreciation and is used in place of the recovery percentages just discussed. Under this method, you may choose a recovery period of either 3, 5, or 12 years for all cars you place in service during the tax year. The straight line recovery percentage for 3 years is 33.333%, 5 years is 20%, and 12 years is 8.333%.

The first year the car is placed in service you deduct half the amount of the depreciation that would be allowed for a full year. It does not matter when during the year you first begin using the car. If you use the car in your business for the entire recovery period you choose, you also deduct half the amount of a full year's depreciation in the tax year after the end of the recovery period. For the tax years in between you deduct the full amount of depreciation.

Example. You bought a car for $9,000 on January 5, 1983, that you use 100% in your business through 1987. You did not take a section 179 deduction, but you did take a reduced investment credit. You chose a 5-year recovery period. The recovery percentage is 20%. Your recovery deduction for 1983 and 1988 is $900 ($9,000 × 20% × ½). Your deduction for each of the years 1984 through 1987 is $1,800 ($9,000 × 20%). You will recover your cost in 1988.

For more information on depreciation, see Publication 534. For more information on basis, see Publication 551, *Basis of Assets.* If you dispose of business property, see Publication 544.

Leasing a Car

If you lease a car to use in your business or work, you may be able to deduct at least part of your lease payments.

Cars leased before June 19, 1984. If you leased a car before June 19, 1984, that you use in your business or work, you may deduct the part of your lease payments that are for the use of the car in your business or work. You cannot deduct any part of the lease payments that are for commuting or other personal use of the car. You must spread any advance payments over the entire lease period. You may not deduct any payments you make to buy a car even if the payments are called lease payments. These rules also apply if you leased a car under a binding contract that was in effect on and after June 18, 1984, and used the car under the lease before 1985.

Cars leased after June 18, 1984. The rules above also apply if you leased a car after June 18, 1984. In addition, if you leased a car after June 18, 1984, that you use in your business or work, you may have to include in your income for each tax year you lease the car an amount called the "inclusion amount." This inclusion amount is a percentage of part of the fair market value of the leased car multiplied by the percentage of business and investment use of the car for the tax year. The inclusion amount is prorated for the number of days of the lease term included in the tax year. If you use the leased car 50% or less for business, you must include in your income an additional inclusion amount. These additions to income effectively limit your deduction for lease payments to equal the limited depreciation deduction and investment credit on a car you own and use for business.

Cars leased after June 18, 1984, and before April 3, 1985. If you leased a car after June 18, 1984, and before April 3, 1985, for a lease term of 30 days or more, you include in your gross income each tax year during which the car is leased an inclusion amount prorated for the number of days of the lease term included in the tax year and multiplied by the percentage of business and investment use for the tax year. These rules also apply to a car you leased pursuant to a binding contract entered into no later than April 2, 1985, and which is in effect at all times thereafter, but only if the car is used under the lease before August 1, 1985.

The inclusion amount is:

1) 7.5% of the excess (if any) of the car's fair market value over $16,500 for each of the first 3 tax years during which a car is leased.
2) 6% of the excess (if any) of the car's fair market value over $22,500 for the fourth tax year during which a car is leased.
3) 6% of the excess (if any) of the car's fair market value over $28,500 for the fifth tax year during which a car is leased.

4) 6% of the excess (if any) of the car's fair market value over $34,500 for the sixth tax year during which a car is leased.

For the seventh and later years during which the car is leased, the inclusion amount is 6% of the excess (if any) of the car's fair market value over the sum of:

1) $16,500, and
2) $6,000 multiplied by the number of tax years in excess of 3 years.

The fair market value is the value on the first day of the lease term. If the capitalized cost of a car is specified in the lease agreement, that amount is treated as the fair market value.

Fair market value is the price at which the property would change hands between a buyer and a seller, neither being required to buy or sell, and both having reasonable knowledge of all the necessary facts. Sales of similar property on or about the same date may be helpful in figuring the fair market value of the property.

Example. On November 1, 1984, you leased for 4 years and placed in service a car to be used exclusively in your business. The lease agreement specified that the capitalized cost of the car was $26,500. While you deducted the $300 rent paid for November and December, you had to include $125.34 in gross income for 1984. The $125.34 is 61/365 of $750 (7.5% of $10,000 ($26,500 − $16,500)). In 1985 your inclusion amount is $750 (7.5% of $10,000).

Business use 50% or less. If a car that is leased after June 18, 1984, and before April 3, 1985, is not used more than 50% for business or work during any tax year, the lessee must include in gross income for that tax year an additional inclusion amount. This is in addition to the inclusion amount discussed above.

If the fair market value of the car, as determined on the first day of the lease term or from the lease agreement, is more than $16,500, the additional inclusion amount is determined by multiplying the average business and investment use by the dollar amount from the following table.

Dollar Amounts

Tax year of lease	Lease term in years 1	2	3	4 or more
First year	$350	$700	$1,350	$1,850
Second year	—	—	650	1,250
Third year	—	—	—	650

The average business and investment use is the average of the business and investment use of the car for the first tax year in which the business use percentage is 50% or less and all prior tax years in which the car is leased.

If the fair market value of the car is $16,500 or less, the additional inclusion amount is the product determined by multiplying the fair market value of the car by the average business and investment use and by the applicable percentage from the following table.

Applicable Percentages

Tax year of lease	Lease term in years 1	2	3	4 or more
First year	3%	6.00%	10.2%	13.2%
Second year	—	1.25%	6.2%	10.4%
Third year	—	—	2.25%	6.5%
Fourth year	—	—	—	1.7%
Fifth year	—	—	—	0.5%

Special rules. If:

1) The lease term begins within 9 months before the end of the lessee's tax year,
2) The property is not predominantly used in a qualified business use during that part of the tax year, and
3) The lease term continues into the lessee's next tax year,

then the total inclusion amount is added to gross income in the lessee's next tax year. The amount is determined by taking into account the average of the business and investment use for both tax years and the appropriate dollar amount or the applicable percentage for the tax year in which the lease term begins.

If the lease term is 30 days or more but less than 1 year, the amount included in gross income is the amount that bears the same ratio to the total inclusion amounts as the number of days in the lease term bears to 365.

The total inclusion amounts cannot be more than the sum of all deductible amounts of rent allocable to the lessee's tax year in which the inclusion and additional inclusion amounts must be included in gross income.

Example 1. On September 1, 1984, you leased for 3 years and placed in service a car with a fair market value of $55,000. You used the car exclusively in your business in 1984. Your inclusion amount for 1984 was $965.14 or 122/365 × $2,887.50 (7.5% × $38,500 ($55,000 − $16,500)).

In 1985 you use the car 50% in your business. For 1985 your inclusion amount is $1,443.75 (7.5% × 50% × $38,500). Your additional inclusion amount is $487.50 ($650 × 75%). The $650 is from the *Dollar Amounts* table for the second tax year of a 3-year lease. The 75% is the average business and investment use for 1984 and 1985.

Example 2. On November 1, 1984, you leased for 6 months and placed in service a van with a fair market value of $16,000. During 1984 you used the van 40% in your business. You had no inclusion amount because the fair market value of the van is less than $16,500. Also, since the lease began within 9 months of the end of your tax year, you had no additional inclusion amount for 1984. The lease ends on April 30, 1985, at which time you have used the van 50% in your business in 1985. For 1985 your additional inclusion amount is $107.11. The $107.11 is the product of $16,000 (the fair market value) times 45% (the average business and investment use) times 3% (the applicable percentage for the first tax year from the table) times 181/365 (the proration for the length of the lease term).

Cars leased after April 2, 1985. If the fair market value of a car leased for a lease term of 30 days or more after April 2, 1985, as determined on the first day of the lease term or from the lease agreement, is more than $11,250 but not more than $18,000, there is an inclusion amount in each of the first 3 years of the lease. If the fair market value is more than $18,000 but not more than $23,000, there is an inclusion amount in each of the first 4 years of the lease. If the fair market value is more than $23,000 but not more than $28,000, there is an inclusion amount in each of the first 5 years of the lease. If the fair market value is more than $28,000 but not more than $32,400, there is an inclusion amount in each of the first 6 years of the lease. If the fair market value is more than $32,400, there is an inclusion amount in each year of the lease.

Fair market value more than $11,250 but not more than $50,000. The inclusion amount for each of the first 3 tax years during which a car is leased is based on the fair market value of the car, the lessee's amount of business use, and the quarter of the tax year during which the car is first used under the lease. For any car that has a fair market value that is not more than $50,000, the inclusion amount is figured as follows:

1) For the appropriate range of fair market values in Table I, found near the end of this publication, select the dollar amount from the column for the quarter of the tax year in which the car is first used under the lease,
2) Prorate the dollar amount for the number of days of the lease term included in the tax year, and
3) Multiply the prorated dollar amount by the percentage of business and investment use for the tax year.

Fair market value more than $18,000 but not more than $50,000. The inclusion amount for the fourth, fifth, and sixth tax years during which a car with a fair market value not more than $50,000 is leased is figured as follows:

1) For the appropriate range of fair market values in Table II, found near the end of this publication, select the dollar amount from the column for the tax year in which the car is used under the lease,
2) Prorate the dollar amount for the number of days of the lease term included in the tax year, and
3) Multiply the prorated dollar amount by the percentage of business and investment use for the tax year.

Fair market value more than $50,000. The inclusion amount for the first 6 tax years during which a car is leased is based on a dollar amount determined by the quarter of the tax year during which the car is first used under the lease and the lessee's business use. The inclusion amount is figured as follows:

1) Determine the dollar amount by using the appropriate formula, discussed next,
2) Prorate the dollar amount for the number of days of the lease term included in the tax year, and
3) Multiply this dollar amount by the percentage of business and investment use for the tax year.

The dollar amount is figured as follows:

If the car is first used under the lease in the fourth quarter of a tax year, the dollar amount for each of the first 3 tax years during which the car is leased is the sum of:

1) $124, and
2) 11% of the excess of the car's fair market value over $13,200.

If the car is first used under the lease in the third quarter of a tax year, the dollar amount for each of the first 3 tax years during which the car is leased is the sum of:

1) $110, and
2) 10% of the excess of the car's fair market value over $13,200.

If the car is first used under the lease in the second quarter of a tax year, the dollar amount for each of the first 3 tax years during which the car is leased is the sum of:

1) $100, and
2) 9% of the excess of the car's fair market value over $13,200.

If the car is first used under the lease in the first quarter of a tax year, the dollar amount for each of the first 3 tax years during which the car is leased is the sum of:

1) $90, and
2) 8% of the excess of the car's fair market value over $13,200.

For the fourth tax year during which the car is leased, the dollar amount is 6% of the excess of the car's fair market value over $18,000.

For the fifth tax year during which the car is leased, the dollar amount is 6% of the excess of the car's fair market value over $22,800.

For the sixth tax year during which the car is leased, the dollar amount is 6% of the excess of the car's fair market value over $27,600.

For any car that has a fair market value of $32,400 or less, the inclusion amount for the seventh and later tax years during which the car is leased is zero.

For any car that has a fair market value over $32,400, the inclusion amount for the seventh and later tax years during which the car is leased is 6% of:

1) The excess (if any) of the car's fair market value over
2) The sum of:
   a) $13,200, and
   b) $4,800 multiplied by the number of tax years in excess of 3 years.

Business use 50% or less. If a car that is leased after April 2, 1985, is not used more than 50% for business or work during a tax year, the lessee must include in gross income for that tax year an additional inclusion amount. This is in addition to the inclusion amount discussed above.

If the fair market value of the car, as determined on the first day of the lease term or from the lease agreement, is more than $11,250, the additional inclusion amount is determined by multiplying the average business and investment use by the dollar amount from the following table.

Dollar Amounts

Tax year of lease	Lease term in years			
	1	2	3	4 or more
First year	$350	$700	$1,150	$1,500
Second year	—	150	700	1,200
Third year	—	—	250	750

The average business and investment use is the average of the business and investment use of the car for the first tax year in which the business use percentage is 50% or less and all prior tax years in which the car is leased.

If the fair market value of the car is $11,250 or less, the additional inclusion amount is determined by multiplying the fair market value of the car by the average business and investment use and by the applicable percentage from the *Applicable percentages* table which appears under *Cars leased after June 18, 1984, and before April 3, 1985*, earlier.

Example 1. On July 15, 1985, you lease and place in service a car with a fair market value of $45,300. The lease is for a period of 5 years, during which you use the car exclusively in your business. For tax years 1985 through 1990, you must include the following amounts in gross income:

Tax year	Dollar amount	Proration	Business use	Inclusion
1985	$3,327	170/365	100%	$1,550
1986	3,327	365/365	100%	3,327
1987	3,327	365/365	100%	3,327
1988	1,650	366/366	100%	1,650
1989	1,362	365/365	100%	1,362
1990	1,074	196/365	100%	577

Example 2. Assume the same facts as in Example (1), except that you use the car only 45% in your business during 1987 through 1990. You must include in gross income an additional inclusion amount in 1987, the first tax year in which the car is not used predominantly in your business. The additional inclusion amount is based on average business use for 1985 through 1987. For tax years 1985 through 1990, you must include the following amounts in gross income:

Tax year	Dollar amount	Proration	Business use	Inclusion
1985	$3,327	170/365	100%	$1,550
1986	3,327	365/365	100%	3,327
1987	3,327	365/365	45%	1,497
1987	750		81.67%	612
1988	1,650	366/366	45%	743
1989	1,362	365/365	45%	613
1990	1,074	196/365	45%	260

Standard Mileage Rate

You may use the standard mileage rate of 21 cents a mile for the first 15,000 miles of business use each year and 11 cents a mile for each additional mile. If the car is, or is considered to be, fully depreciated as explained later, the standard mileage rate is 11 cents a mile. You may use this rate instead of actual operating and fixed expenses and depreciation in figuring the deductible costs of operating a passenger car, including a van, pickup, or panel truck. You may use the standard mileage rate whether or not you are reimbursed and whether or not the reimbursement is more or less than the amount figured using the standard mileage rate. See *How to Report*, later.

When standard mileage rate may be used. If you first place your car in service after 1980, you may not use the standard mileage rate unless you use it in the first year you place your car in service in your business. Otherwise use of the standard mileage rate is optional each year.

If you use the standard mileage rate in the first year you place your car in service after 1980, you are considered to have made an election to exclude the car from the accelerated cost recovery system (ACRS), discussed earlier. If you change to the actual cost method in a later year, but before your car is considered fully depreciated, you have to estimate the useful life of the car and use straight line depreciation.

You may use the standard mileage rate for only one car at a time in your business or work. You also must:

1) Own the car,
2) Not use the car for hire, such as for a taxi,
3) Not operate a fleet of cars using two or more at the same time,
4) Not have claimed depreciation using any method other than the straight line method,
5) Not have claimed additional first year depreciation on the car, and
6) Not have claimed the section 179 deduction on the car.

Fully depreciated. If you use the standard mileage rate to figure your operating costs for the first year your car is placed in service in your business after 1979, the car is considered fully depreciated after 60,000 miles of business use at the maximum standard mileage rate. For this purpose a car is considered to have been driven no more than 15,000 business miles in any one year, even though the actual business mileage may be more. Depreciation is considered to be allowed at the rate of 7 cents a mile for 1980 and 1981, 7½ cents a mile for 1982, and 8 cents a mile for 1983, 1984, and 1985, except that if the actual cost method is used for one or more of those years these rates will not apply to any year the actual cost method is used. This depreciation reduces the basis of your car to determine the adjusted basis when you dispose of it.

If you used the actual cost method to figure the cost of operating your car before 1981, the useful life of the car for business purposes is the estimated period on which you figured the allowable straight line depreciation deduction for that year, even if you change to the standard mileage rate in later years. The car is considered fully depreciated at the end of the estimated period.

If your car is fully depreciated under the straight line method or is considered fully depreciated under the 60,000 mile rule, you may deduct only 11 cents a mile for all miles of business use.

Example. In 1982 you bought a car for use in your business. From 1982 through 1985 you use the standard mileage rate to figure your car expense deduction. You drove your car at least 15,000 business miles each year from 1982 through 1984. In 1985 you drove 20,000 business miles. In 1985 you may deduct $3,700 (15,000 miles × 21 cents plus 5,000 miles × 11 cents). Your car is considered fully depreciated in 1985 because you have taken deductions for 60,000 miles at the maximum rate. If you use the standard mileage rate for the same car in 1986, you cannot figure any of your expense at the maximum rate. If you change to the actual cost method in 1986, you cannot take a depreciation deduction for that car.

Interest and state and local taxes. You may deduct the part of interest and state and local taxes, other than the gas tax, for the business use of your car as a business expense in addition to the standard mileage rate. Interest and taxes for the nonbusiness use of your car are discussed earlier.

Parking fees and tolls you have during business use are deductible in addition to the standard mileage rate.

Separate businesses. If you and your spouse use your jointly owned car in your separate businesses for a combined total of more than 15,000 miles a year, you may use the standard mileage rate of 21 cents a mile only for the first 15,000 miles. You must use the 11 cents a mile rate for each additional mile of business use whether you file separate returns or a joint return. However, if you and your spouse use separately owned cars in your separate businesses, you do not have to combine the mileage of both cars to use the standard mileage rate. Use the standard mileage rate of 21 cents a mile for the first 15,000 miles of business use of each car and use the 11 cents a mile rate for each additional mile of business use of each car.

Alternating cars. If you use more than one car, not at the same time but on an alternating basis, the total business mileage of both cars must be combined to figure the 15,000 mile annual limit on the 21-cent mileage rate. However, if one car is, or is considered to be, fully depreciated, do not combine the total business miles of both cars because you may only take 11 cents a mile for the depreciated car.

Example 1. You are a sales representative, and do not receive an allowance from your employer for the use of your car. You own two cars, one you use primarily for business and the other primarily for personal purposes. However, occasionally you use the second car for business. Neither car is fully depreciated this year. If you drive the first car 14,000 business miles during the year and drive the second car 2,000 business miles, you may deduct $3,280 (15,000 miles × 21 cents plus 1,000 miles × 11 cents).

Example 2. If, in Example 1, the car you use primarily for business is fully depreciated, you

may only take 11 cents a mile for the 14,000 miles that car was driven. You may deduct $1,960 (14,000 miles × 11 cents plus 2,000 miles × 21 cents).

Replacing your car. If you replace your car during the year and choose to use the standard mileage rate for both the old and new cars, figure your deduction by combining the total business mileage of both cars for the year. However, if the old car is, or is considered to be, fully depreciated, do not combine the total business mileage of both cars. You may only take 11 cents a mile for the old car. See the preceding examples.

If you are reimbursed or receive an allowance for your car expenses, you may use the standard mileage rate to find the cost of operating your car. However, you may deduct only the cost that is more than your reimbursement or allowance. See *Partial Reimbursement*, later.

You are reimbursed or receive an allowance if you are paid cash for the use of your car, charge car expenses to your employer, or your employer pays any of the expenses of operating your car.

Example. You drive your car 14,000 miles in your work. You get $900 worth of gas from your employer, who has a gas pump for the business. You decide to use the standard mileage rate to figure your car expenses. You may deduct $2,040 (14,000 miles × 21 cents a mile = $2,940 − $900 for the gas). If you received $2,940 or more, including the value of the gas, from your employer, you have no deduction. You must include any amount above $2,940 in your income.

Car Expense Records

Whether or not you use the standard mileage rate, you must keep records to show when you started using your car for business and the cost or other basis of the car. Your records must also show the business miles you drove your car during the year and the total miles you drove your car during the year. If you use actual expenses, you must keep records of the costs of operating the car, such as car insurance, interest, taxes, licenses, maintenance, repairs, depreciation, gas, and oil. If you lease a car, you must keep records of this cost. To the extent the car expenses reflect travel away from home, you will be considered to have met the proof requirement for that expense, as explained later under *Records*, if you can prove the actual business mileage you drove.

Entertainment Expenses

You may be able to deduct entertainment expenses you have for your trade or business. You may take the deduction if the amounts spent are directly related to or associated with your trade or business or if certain exceptions apply. You must meet requirements for proving the amount spent and the business nature of the expense.

Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. This covers entertaining guests at night clubs, social, athletic, and sporting clubs, theaters, sporting events, on yachts, or on hunting, fishing, vacation, and similar trips. See *Entertainment Facilities*, later.

It also may include satisfying personal, living, or family needs of individuals, such as the furnishing of food, a hotel suite, or a car to business customers or their families.

Entertainment does not include supper money you give employees, a hotel room you keep for your employees while on business travel, or a car used in your business even though used for routine personal purposes, such as commuting to and from work. However, if you provide the use of a hotel suite or a car to your employee who is on vacation, this is entertainment of the employee. For deductibility of these items, see *Exceptions*, later.

Furnishing entertainment to a nonemployee who must include it in income and reimbursing entertainment expenses of a self-employed person are discussed later under *Exceptions*.

Your kind of business may determine if a particular activity constitutes entertainment. For example, if you are a dress designer and have a fashion show to introduce your new designs to store buyers, the show generally is not considered entertainment. But, if you are an appliance distributor and conduct a fashion show for the spouses of your retailers, the show generally is considered entertainment.

Ordinary and necessary. To be deductible, entertainment expenses must be ordinary and necessary expenses of carrying on your trade or business or for the production or collection of income. You must be able to prove them, as explained later under *Records*. You must also be able to show that they are:

1) ***Directly related*** to the active conduct of your trade or business,
2) ***Associated*** with the active conduct of your trade or business, or
3) Covered under one of the exceptions, discussed later.

Lavish or extravagant. Expenses for entertainment that are lavish or extravagant are not allowed. An expense is not considered lavish or extravagant if it is reasonable considering the facts and circumstances. Entertainment expenses will not be disallowed merely because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, night clubs, and resorts.

Business and nonbusiness. You must divide your entertainment expenses between business and nonbusiness. You may deduct only the business part. For example, if you entertain a group of individuals, three business prospects and seven social guests, you may deduct four-elevenths of the expense.

Property used 50% or less for business. For most property placed in service after June 18, 1984, of a type generally used for entertainment, recreation, or amusement that is used 50% or less in your business, you cannot take the investment credit or the section 179 deduction, and you must figure depreciation on this property using the straight line method. If this property was used more than 50% in your business in the year placed in service, but business use is 50% or less in a subsequent year, you may have to recapture the investment credit and any excess depreciation. For more information, see Publications 572 and 534.

Directly Related Entertainment

For an entertainment expense to meet the directly related test, you must show that:

1) You had more than a general expectation of getting income or some other specific business benefit at some future time (see *Goodwill*, later),
2) You did engage in business with the person being entertained during the entertainment period, and
3) The main purpose of the combined business and entertainment was the business transaction.

You are not required to show that business income or other business benefit actually resulted from each entertainment expense.

You must consider all the facts including the nature of the business transacted and the reasons for conducting business during a period of entertainment. It is not necessary to devote more time to business than to entertainment. However, if the business discussion is only incidental to the entertainment, it does not qualify.

Business is not considered to be the main purpose when business and entertainment are combined on hunting or fishing trips, or on yachts and other pleasure boats, unless you can show otherwise. Even if you show that business was the main reason, you generally may not deduct the expenses for the use of an entertainment facility. See *Entertainment Facilities*, later.

Clear business setting. If the entertainment is in a clear business setting and is for your business or work, the expenses are considered directly related to your business or work. The following situations are in a clear business setting:

1) Entertainment in a hospitality room at a convention where business goodwill is created through the display or discussion of business products,
2) Entertainment that has the main effect of a price rebate in the sale of your products, such as, occasional free meals furnished by a wholesaler or retail store to regular customers, and
3) Entertainment of a clear business nature occurring under circumstances where there is no meaningful personal or social relationship between you and the persons entertained (for example, entertainment of business and civic leaders at the opening of a new hotel or play when the purpose is to get business publicity rather than to create or maintain the goodwill of the persons entertained).

Expenses generally are not considered directly related when entertainment occurs where there is little or no possibility of engaging in the active conduct of business. Examples are meetings at night clubs, theaters, sporting events, or essentially social gatherings, such as cocktail parties, or meetings with a group that includes persons other than business associates at places such as cocktail lounges, country clubs, golf clubs, athletic clubs, or vacation resorts. You may prove otherwise by showing that you engaged in a substantial business discussion during the entertainment.

Associated Entertainment

You may deduct entertainment expenses that do not meet the directly related test but are associated with your trade or business if the entertainment directly precedes or follows a substantial business discussion.

Generally, any ordinary and necessary entertainment expense is associated with the active conduct of your trade or business if you can show that you had a clear business purpose in having the expense. The purpose may be for getting new business or encouraging the continuation of an existing business relationship. However, any part of the expense for persons not closely connected with those who attended the substantial business discussion are not considered associated with the active conduct of your business.

Expenses for spouses. You may not deduct the cost of entertainment for your spouse or for the spouse of a business customer unless you can show that you had a clear business purpose rather than a personal or social purpose for providing the entertainment.

Example. You entertain a business customer. The cost is an ordinary and necessary business

expense and is allowed under the entertainment rules. The customer's spouse joins you because it is impractical to entertain the customer without the spouse. You may deduct the cost of entertaining the customer's spouse as an ordinary and necessary business expense. Furthermore, if your spouse joins the party because the customer's spouse is present, the cost of the entertainment for your spouse is also an ordinary and necessary business expense.

Substantial business discussion. Whether a business discussion is substantial depends on all the facts of each case. You must show that you or your representative actively engaged in a discussion, meeting, negotiation, or other business transaction, other than entertainment, to get income or some other specific business benefit. You may be able to deduct goodwill entertainment. See *Goodwill*, later.

The meeting does not have to be for any specified length of time, but you must show that the business discussion was substantial in relation to the entertainment. It is not necessary that you devote more time to business than to entertainment. You do not have to discuss business during the entertainment.

Meetings at conventions. You are considered to have a substantial business discussion if you attend meetings at a convention or similar event, or at a trade or business meeting sponsored and conducted by a business or professional organization. However, you must attend the convention or meeting to further your trade or business and the organization that sponsors the convention or meeting must schedule a program of business activities that is the main activity of the convention or meeting.

Directly before or after business discussion. Entertainment on the same day as the business discussion is considered directly before or after the business discussion. However, if the entertainment and the business discussion are not on the same day, the facts of each case will be considered to see if the rule is met. Among the facts to be considered are the place, date, and duration of the business discussion, whether you or your business associates are from out of town, and, if so, the dates of arrival and departure, and the reasons the entertainment and the discussion did not take place on the same day.

For example, a group of business associates come from out of town to your place of business to hold a substantial business discussion. The entertainment of those business guests and their spouses on the evening before the business discussion, or on the evening of the day after the business discussion, generally is considered directly before or after the discussion.

Goodwill. You may deduct entertainment expenses to keep or create business goodwill under:

1) The business meal rule (discussed later under *Exceptions*),
2) The associated entertainment rule, if the entertainment is associated with the active conduct of your business and directly precedes or follows a substantial business discussion, or
3) The directly related entertainment rule, if the entertainment is in a clear business setting.

Example. Carol Crain, one of your customers, lives in a distant city. She contacts you when she is going through your town, and you take her out to dinner at an exclusive restaurant where there are no substantial distractions. Carol spends a large amount of money with your firm during the year, and you are simply trying to retain her goodwill. You may deduct the ordinary and necessary expenses of this entertainment because it comes within the business meal exception.

Entertainment Facilities

An entertainment facility is any property you own, rent, or use for entertainment. The only entertainment facility (subject to the *Exceptions*, discussed later) for which you may deduct the expense is a club. This includes social, athletic, sporting, and country clubs.

Entertainment facilities for which you generally may not deduct expenses include a yacht, hunting lodge, fishing camp, swimming pool, tennis court, bowling alley, car, airplane, apartment, hotel suite, or a home in a vacation resort. However, you may deduct expenses for the business use of these facilities for purposes other than entertainment. If you use a facility only incidentally for entertainment, it is not considered to be an entertainment facility.

Interest, taxes, and casualty losses on your entertainment facilities are deductible without regard to the use of the facility in your business. You may deduct these items as ordinary interest, taxes, or casualty losses.

Clubs include country, sporting, social, and athletic clubs. They are considered to be entertainment facilities. The purposes and activities of a club, and not its name, determine its character. Dues and fees you pay to a club are treated as being for the use of an entertainment facility. If you use the club more than 50% for business purposes, you can deduct the part of your dues that is ***directly related*** to your business use of the club.

If you use a club for business meals and beverages under circumstances conducive to the discussion of business, the part of the dues or fees for this use is directly related entertainment.

Example. Your dues in a club are $1,200 a year and you use it 60% for your business—20% for business meals, 25% for directly related entertainment, and 15% for associated entertainment. Because more than 50% of your use of the club is for your trade or business, you are entitled to a deduction. But you may deduct only 45% of your club dues paid during the year, 20% for the use for business meals and 25% for directly related entertainment. Although you may consider the associated entertainment expenses in determining whether you use the club primarily for business, you may not deduct the part of dues for that use.

If, on the other hand, you used the club only 45% for entertaining for your trade or business, you may not deduct any of your dues even though all the 45% use was directly related to your trade or business.

Determination of primary use. There are no set rules for seeing whether more than 50% of the use of a club is for business purposes. You must consider all the facts and circumstances including the nature of each use, how often and how long you use it for business compared with personal purposes, the amount spent for each use, and other pertinent facts.

You may apply the specific tests in the following discussions to find the primary use. Consider all ordinary and necessary business uses of a club, although not directly related entertainment, in seeing whether the club is used more than 50% for business purposes.

Days of business use. If the primary use of a club during a day is an ordinary and necessary business use, it is a day of business use. If you, or your employee, use a club for a substantial business discussion on a particular day, that day is considered a day of business use even though the club is also used on the same day for personal or family purposes not involving the entertainment of others. Do not count the days the club is not used in determining whether it is used more than 50% for business.

You meet the primary-use test for a club, if you can show that more than 50% of the total days of use during the year were days of business use.

Example. You used your club a total of 200 days. Your records show that 110 days, or 55% of the total days of use during the year, were days of business use and 90 days were for personal or family use. You satisfy the primary-use test because you used the club more than 50% of the total days of use for your business or work.

Membership fee. A membership or initiation fee you pay only once to join a club is a capital expense if the useful life of the membership may extend beyond the first year. You may not deduct it.

Dues to a luncheon club or any club operated solely to provide business lunches are not considered dues to a club. Dues to professional associations and civic organizations, such as medical associations, are not considered dues to a club. You may deduct these types of dues if they qualify as ordinary and necessary expenses in your business.

Out-of-pocket expenses, such as for food and beverages, catering, gas, and fishing bait, provided during entertainment at a facility may be deductible subject to the general entertainment rules.

Box seats or season tickets to theaters or sporting events are not treated under the club rules. You must divide the cost of these items between the separate events. You may be able to deduct the expense for one event regardless of whether the box seats or season tickets are used more than 50% for business purposes.

Sale, exchange, or other disposition of a facility. An entertainment facility is considered held for personal use to the extent deductions are not allowed. If it is sold, exchanged, or otherwise disposed of, or suffered a casualty, the rules for nonbusiness property apply to your gain or loss.

If a part of the expenses of a facility were allowable, you must treat its sale, exchange, or other disposal as a disposition of two pieces of property. You treat the part that had deductible expenses as an asset used in business. The balance will be covered by the rules for nonbusiness property. For more information, see Publication 544, *Sales and Other Dispositions of Assets*.

Exceptions

Ordinary and necessary expenses you have under the circumstances in the following discussions are not subject to the restrictions on entertainment expenses. To deduct them, you must be able to prove the expenses. See *Records*, later.

Business meals furnished to an individual under circumstances generally considered conducive to a business discussion may be deducted, but reciprocal meals may not. In seeing whether the circumstances are conducive to a business discussion, you must take into account the surroundings, your business or work, and the relationship to your business of the person to whom the meal is provided. This same rule applies to beverages served apart from meals.

The business meal exception ordinarily applies to food and beverages served in restaurants or hotel dining rooms. There may be circumstances when this exception will apply to expenses for meals or beverages served in your home. You must show that the expenses are commercially rather than socially motivated.

A night club or place where entertainment is a major attraction generally is not considered a suitable environment for a business discussion.

If you prove that the circumstances are conducive to a business discussion, it is not essential that business actually be discussed. However, you must show that the food or beverages were provided for the primary purpose of furthering your business or work and not primarily for social or personal purposes.

The cost of meals that are part of a business program or banquet sponsored by business or professional associations comes within the business meal exception. It is not always necessary that you attend the lunch or dinner.

Example. A dental equipment supplier buys a table at a dental association banquet for dentists who are actual or prospective customers. The cost of the table comes within the business meal exception.

Corporate membership costs for club dining facilities used by designated officers and executives for entertaining prospective customers, negotiating business, and for holiday and retirement parties are deductible business expenses if they can be proved.

Your meals. Generally, you may deduct the cost of meals you had while entertaining for business purposes, as long as you are not claiming substantial deductions for personal living expenses.

Reciprocal entertaining. Expenses are *not* deductible when a group of business acquaintances take turns picking up each other's entertainment checks without regard to whether any business purposes are served.

Company cafeteria or executive dining room. You may deduct the cost of food and beverages provided on your business premises primarily to your employees. This includes the cost of maintaining the facilities for providing the food and beverages.

Employee activities. You may deduct the expense of providing recreational, social, or similar activities, or for use of a facility, primarily for the benefit of your employees. However, officers, shareholders, owners, or highly compensated employees are not considered employees in determining whether the activity is primarily for the benefit of your employees. A person is a shareholder or owner for this test only if the person and his or her family hold a 10% or more interest in the business.

Example. The Ace Company builds a swimming pool primarily for the use of all its employees. The company may deduct the cost of operating the pool, including depreciation and maintenance. However, if the use of the pool were restricted to the officers of the company and a few other highly paid employees, the pool would be an entertainment facility and no deduction would be allowable. See *Entertainment Facilities,* earlier.

Entertainment treated as compensation. You may deduct the expense of giving an employee goods, services, the use of a facility, or an allowance that generally is considered entertainment if you treat the expense as compensation to the employee on your income tax return. You must withhold federal income tax from this compensation. This compensation when added to the employee's other compensation must be reasonable.

Employee's entertainment expenses. If your employer treats your allowances or reimbursements for entertainment as additional compensation to you or expects you to pay your own expenses, you may deduct club dues subject to the rules discussed earlier. You may deduct other entertainment expenses that are not for the use of an entertainment facility, if they are directly related entertainment, associated entertainment, or within one of the exceptions, such as business meals. If, however, you are reimbursed or have another expense allowance arrangement that your employer does not treat as compensation, you may deduct the unreimbursed part of these expenses, including the expenses for the use of an entertainment facility, if they are reasonable and are ordinary and necessary in your business or work.

Self-employed and reimbursed for entertainment. If you are self-employed and your client or customer reimburses you or gives you an allowance for entertainment expenses you have in connection with services you perform, you may deduct these expenses, including the expenses for the use of an entertainment facility, if they are reasonable and ordinary and necessary in your business or work. To take the deduction you must account to your client or customer. If you do not account to your client or customer, whether or not you have a reimbursement or allowance arrangement, the only entertainment facility expense you may deduct is for a club. You may deduct club dues subject to the rules discussed earlier. You may deduct other entertainment expenses that are not for the use of an entertainment facility if they are directly related to or associated with your business or come within one of the exceptions, such as business meals.

Entertainment provided to person not an employee. If you provide a person who is not your employee with goods, services, or the use of a facility that is considered entertainment, you may deduct these expenses to the extent they are includible in the gross income of the recipient as compensation for services or as a prize or award. You must file any necessary information return (Form 1099–MISC).

Director, stockholder, or employee meetings. You may deduct expenses directly related to business meetings of your employees, partners, stockholders, agents, or directors. You may provide some minor social activities, but the main purpose of the meeting must be the company's business.

Trade association meetings. You may deduct entertainment expenses that are directly related to and necessary for attending business meetings or conventions of certain exempt organizations. These organizations include business leagues, chambers of commerce, real estate boards, trade associations, and professional associations.

Advertising expenses. You may deduct the cost of providing entertainment or recreational facilities to the general public as a means of advertising or promoting goodwill in the community. For example, the expense of sponsoring a television or radio show is deductible, as is the distribution of free samples to the general public.

Sale of entertainment. You may deduct the cost of providing entertainment, goods and services, or use of facilities that you actually sell to the public. For example, if you run a night club, your expense for the entertainment you furnish to your customers, such as a floor show, is a business expense.

Business Gift Expenses

You may deduct the cost of business gifts. However, you cannot deduct more than $25 for business gifts you give, directly or indirectly, to any one individual during your tax year. If a gift to a company is not intended for the eventual personal use or benefit of a particular person or a limited class of people, it will not be considered an indirect gift to an individual.

A gift to the spouse or child of a person with whom you are doing business is a gift to that person. However, if the spouse you give the gift to has an independent bona fide business connection with you, the gift generally will not be considered a gift to the other spouse, unless it is intended for that spouse's eventual use or benefit.

If you and your spouse both give gifts, both of you are treated as one taxpayer, even if you have ***separate businesses*** or are ***separately employed*** and even if each of you has an independent connection with the recipient. If a partnership gives gifts, the partnership and the partners are treated as one taxpayer.

Exceptions. The following items are not considered gifts subject to the $25 limit:

1) An item that costs $4 or less, on which your name is clearly and permanently imprinted, and which is one of a number of identical items you distribute generally. This includes items such as pens, desk sets, and plastic bags and cases.
2) Signs, display racks, or other promotional material to be used on the business premises of the recipient.
3) Up to $400 of the cost of an item of tangible personal property awarded to an employee because of length of service, productivity, or safety achievement.
4) Up to $1,600 of the cost of an item of tangible personal property awarded to an employee as a qualified plan award because of length of service, productivity, or safety achievement.

The value of the awards described in (3) and (4) must be included in the employee's gross income, unless it can be shown that the award was given because of the employer's detached generosity and in no way represented compensation for services rendered.

Qualified plan award. Tangible personal property awarded to an employee is a qualified plan award if:

1) The award is part of an employer's permanent written plan that does not discriminate in favor of officers, shareholders, or highly paid employees as to eligibility or benefits, and
2) The average cost of all items awarded under all plans of the employer is $400 or less during the tax year.

Incidental costs, such as engraving on jewelry, or packaging, insuring, and mailing, are not generally included in determining the cost of a gift for the $25 rule.

A related cost is considered incidental only if it does not add substantial value to the gift. For example, the cost of gift wrapping is considered an incidental cost, but the purchase of an ornamental basket for packaging fruit is not considered an incidental cost of packaging if the basket has a value that is substantial in relation to the value of the fruit.

Gift or entertainment. Any item that might be considered either entertainment or a gift generally will be considered as entertainment. However, if you give a customer packaged food or beverages intended to be used at a later date, it is a gift.

If you provide tickets to a theater performance or sporting event for a business customer and do not go with the customer to the performance or event, you may treat the tickets either as a gift or as entertainment, whichever is to your advantage. You may change your treatment of the tickets at a later date, but not after the time prescribed for the assessment of income tax. In most instances this is 3 years after the due date of your income tax return. If you go with the customer to the event, you have no choice; the cost of the tickets is entertainment.

How to Report

The following discussions explain how to report your allowable expenses for travel, local transportation, entertainment, and gifts. If you

have educational expenses, see Publication 508, *Educational Expenses*.

Form 2106. Form 2106 is used to show employee business expenses. Attach this form to your Form 1040 if you are not an outside salesperson and you have reimbursed or unreimbursed transportation, travel, or car expenses or other expenses that are reimbursed, or if you are an outside salesperson and you have any reimbursed or unreimbursed expenses. However, you do not have to attach the form if you accounted to your employer (as explained later) and:

1) Your expenses are equal to the total of your reimbursements and allowances,
2) Your expenses are more than the total of your reimbursements and allowances and you do not deduct the excess expenses, or
3) Your expenses are less than your reimbursements and allowances and your employer does not include the total reimbursements and allowances on Form W–2. In this case, include the amount by which the reimbursements and allowances are more than your expenses on line 7 of Form 1040.

Business use of cars and other vehicles. If you claim a deduction or credit for any vehicle on your tax return, you must answer certain questions providing information about the use of the vehicle. The information required on the tax return relates to mileage (total, business, commuting, and other personal mileage), percentage of business use, date placed in service, use of other vehicles, after-work use, whether you have evidence to support the business use claimed on the return, and whether or not the evidence is written.

Employees. Employees who are deducting expenses for business use of a car or other vehicle must complete Section A of Part II of Form 2106 to provide this information.

Employers. Any employer that provides the use of a vehicle to an employee must obtain information from the employee sufficient to complete the employer's tax return. Any employer that provides more than five vehicles to its employees need not include any information on its return. The employer, instead, must obtain the information from its employees, indicate on its return that it has obtained the information, and retain the information received. Any employer:

1) That can satisfy the requirements of a written policy statement for vehicles not used for personal purposes,
2) That can satisfy the requirements of a written policy statement for vehicles not used for personal purposes other than commuting, or
3) That treats all use of vehicles by employees as personal use,

need not obtain information for those vehicles, but instead must indicate on its return that it has vehicles exempt from these requirements.

Employers, including sole proprietors, who are deducting expenses for business use of a car or other vehicle must complete Part III of Form 4562 to provide this information.

Full Reimbursement

You receive full reimbursement for your expenses if the reimbursements and allowances you receive from your employer equal or are more than your expenses.

Reimbursements equal expenses. If your allowances and reimbursements equal your expenses and you do not account to your employer, you must attach Form 2106 to your Form 1040. Show reimbursed car expenses for travel and local transportation, fares for local transportation, and expenses for travel fares, meals, lodging, and related items away from home on lines 1 through 4 of Part I, Form 2106. Show your other reimbursed expenses, such as entertainment and gift expenses, on line 5. If you are an outside salesperson, show your reimbursed other expenses on line 6 and leave line 5 blank.

If your employer includes the reimbursement in box 10 on Form W–2, include that amount in your income on line 7 of Form 1040. The amount of expenses you can deduct is shown on line 9 of Part I, Form 2106. Deduct this amount on line 25 of Form 1040. If your employer does not include the reimbursement on Form W–2, show the reimbursement on line 8 of Part I, Form 2106. The amount on line 9 of Part I, Form 2106, will then be zero. If your expenses are more than the reimbursement or allowance you received from your employer, see *Partial Reimbursement*. Form 2106 is shown at the end of this publication.

Reimbursements more than expenses. If the reimbursements and allowances you receive from your employer are more than your expenses and your employer includes the total reimbursements on your Form W–2, you must attach Form 2106 to your Form 1040. It does not matter whether or not you account to your employer. Include your total reimbursements on line 7 of Form 1040. Fill out Form 2106 and deduct your expenses as explained under *Reimbursements equal expenses*, above.

You will also have to attach Form 2106 to your Form 1040 if your employer does not include reimbursements on your Form W–2 and you do not account to your employer. In this case, enter your reimbursements on line 8 of Part I, Form 2106. Then include the amount from line 10 of Part I, Form 2106, on line 7 of Form 1040. Line 9 of Part I, Form 2106, will be blank. If you account to your employer, see item (3) under *Form 2106*, earlier.

Reimbursements for personal expenses received from your employer must be included in your income on line 7 of Form 1040. For example, you must include in income amounts received from your employer for meals on business trips that did not involve travel away from home. These expenses are personal and you may not deduct them.

You are reimbursed or given an allowance for your expenses if you charge expenses to your employer or your employer pays you for your expenses with a separate payment or if the payment for your expenses is combined with wages in a single payment and the amount of the reimbursement or allowance is shown separately.

You are not reimbursed or given an allowance for your expenses if you are paid a salary or commission with the understanding that you will pay your own expenses.

If you do not claim from your employer a reimbursement to which you are entitled, you may not claim a deduction for the expenses to which that reimbursement applies.

Partial Reimbursement

If you received an expense allowance or were reimbursed by your employer in an amount that was less than the expenses you had in your work and you want to deduct the excess expenses, attach Form 2106 to your Form 1040.

Outside salesperson. Show your reimbursed or unreimbursed car expenses for travel and local transportation, fares for local transportation, expenses for travel fares, meals, lodging, and related items while away from home, and other expenses, such as entertainment and gift expenses, on lines 1 through 4 and line 6 of Part I, Form 2106. If your employer includes the reimbursement in box 10 on Form W–2, include that amount on line 7 of Form 1040. If your employer does not include the reimbursement on Form W–2, show the reimbursement on line 8 of Part I, Form 2106. The deductible amount is shown on line 9 of Part I, Form 2106. Deduct this amount on line 25 of Form 1040. See *Outside salespersons*, later, for the definition of outside salespersons.

If you are an employee, not an outside salesperson, show your reimbursed or unreimbursed car expenses for travel and local transportation, fares for local transportation, and expenses for travel fares, meals, lodging, and related items while away from home on lines 1 through 4 of Part I, Form 2106. Show your other reimbursed expenses, such as entertainment and gift expenses, on line 5 of Part I, Form 2106. Deduct the amount shown on line 9 of Part I, Form 2106, on line 25 of Form 1040. Deduct your other unreimbursed expenses on line 22 of Schedule A (Form 1040) if you itemize your deductions.

If your employer does not specify the expenses for which you are paid, you must figure what part of the total amount received is for car expenses for travel and local transportation, fares for local transportation, and expenses for travel fares, meals, lodging, and related items while away from home, and what part is for other expenses.

You can do this by multiplying the total amount you received by a fraction. The numerator (top number) is your total expense for car expenses for travel and local transportation, fares for local transportation, and expenses for travel fares, meals, lodging, and related items while away from home. The denominator (bottom number) is the total of all your business expenses for the year. This gives you the amount received for car expenses for travel and local transportation, fares for local transportation, and expenses for travel fares, meals, lodging, and related items while away from home. The balance is for other expenses.

Example 1. You are an employee (not an outside salesperson) and you received $1,500 from your employer during the year for expenses, which was included in box 10 on Form W–2. You included the $1,500 in your income on line 7 of Form 1040. Your employer did not specify which expenses were reimbursed. Your business expenses for the year totaled $2,000, broken down as follows:

Car expenses for travel and local transportation	$ 500
Fares for local transportation	120
Travel fares, meals, lodging, and related items while away from home	880
Total	$1,600
Other business expenses	400
Total expenses	$2,000
Total reimbursement received	1,500
Excess of expenses over reimbursement	$ 500
Total for fares, meals and lodging, and car expenses	$1,600
Reimbursement for fares, meals and lodging, and car expenses [($1,600 ÷ $2,000) × $1,500]	1,200
Unreimbursed travel fares, meals and lodging, and car expenses	$ 400
Total of other expenses	$ 400
Reimbursed other expenses ($1,500 − $1,200)	300
Unreimbursed other expenses	$ 100

On the Form 2106 you attach to your Form 1040, show $500 on line 1, $120 on line 3, $880 on line 4, $300 on line 5, and $1,900 on lines 7 and 9 of Part I, Form 2106. You do not show anything on line 8 of Part I, Form 2106, because you included your $1,500 reimbursement on line 7 of Form 1040. Deduct the $1,900 shown on line 9 of Part I, Form 2106, on line 25

of Form 1040. Deduct your unreimbursed other expenses of $100 on line 22 of Schedule A (Form 1040).

If your employer does not include your $1,500 reimbursement on Form W–2, show $1,500 on line 8 and $400 on line 9 of Part I, Form 2106. Deduct the $400, shown on line 9 of Part I, Form 2106, on line 25 of Form 1040. Deduct the $100 unreimbursed other expenses on line 22 of Schedule A (Form 1040).

Example 2. You drive your car 4,000 business miles and 12,000 total miles during the year and are reimbursed $680 by your employer, which was not included in box 10 on Form W–2. You figure your car expenses using the standard mileage rate, discussed earlier. You use Form 2106, and fill in Section A and Section B (lines 1 through 15) of Part II and lines 1, 7, 8, and 9 of Part I. Your car expenses are $840 (4,000 miles × 21 cents a mile). You figure this amount in Part II. In Part I, show $840 on lines 1 and 7, $680 on line 8, and $160 on line 9. Deduct $160 on line 25 of Form 1040.

No Reimbursement

If you are not reimbursed and you have travel, transportation, or car expenses to deduct or if you are an outside salesperson with any business expenses to deduct, you must attach Form 2106 to your Form 1040. Show your car expenses for travel and local transportation, fares for local transportation, and expenses for travel fares, meals, lodging, and related items while away from home on lines 1 through 4 of Part I, Form 2106. If you are an outside salesperson, show your other expenses, such as entertainment and gift expenses, on line 6 of Part I, Form 2106. Deduct the amount shown on line 9 of Part I, Form 2106, on line 25 of Form 1040. If you are not an outside salesperson, deduct your other expenses on line 22 of Schedule A (Form 1040) if you itemize your deductions.

Accounting to Employer

You account to your employer by giving your employer documentary evidence and an account book, diary, or similar record in which you entered each expense at or near the time you made it.

You must account for all amounts received from your employer during the tax year as advances, reimbursements, or allowances for travel, entertainment, gifts, or any other expenses. This includes amounts you charge to your employer by credit card or otherwise. You must give your employer the same type of records and supporting information that you would be required to keep to prove the deductions on your return.

Standard mileage rate. If you receive an allowance or reimbursement of not more than the standard mileage rate of 21 cents a mile for business transportation while traveling away from home, and the time, place, and business purpose of the travel are proved, as explained later under *Records*, you will be considered to have made an adequate accounting to your employer. A similar allowance or reimbursement for business transportation while not away from home also will qualify as having been adequately accounted for. However, if you receive an allowance or reimbursement for business transportation that is more than the standard mileage rate, you will ***not*** be considered to have made an adequate accounting to your employer. Also, you may receive a separate allowance or reimbursement for parking fees and tolls for business travel and transportation.

Per diem allowance or reimbursement. If, instead of getting reimbursed for living expenses, you get a fixed allowance or reimbursement that is not more than $44 a day, or the maximum daily rate authorized to be paid by the federal government in the locality in which the travel is performed, you satisfy the adequate accounting requirements if:

1) Your employer reasonably limits payments of the travel expenses to those that are ordinary and necessary in the conduct of the trade or business, and
2) The time, place, and business purpose of the travel are proved, as explained later under *Records*.

If the Internal Revenue Service finds that an employer's travel allowance practices are not based on reasonably accurate estimates of travel costs, including recognition of cost differences in different localities, the employees will not have accounted to their employer and will be required to prove their expenses.

These rules also apply if you get reimbursed only for your meal expenses or get a per diem allowance that is not more than the standard meal allowance, discussed earlier, because you have no lodging expense during your travel away from home. You would have no lodging expense if your employer furnishes lodging in kind or pays directly for your lodging, or if you stay with friends or relatives or sleep in the cab of your truck.

Living expenses include, but are not limited to, reasonable travel expenses for meals and lodging, laundry, cleaning and pressing of clothing, and fees and tips for services. They do not include transportation, taxi fares, or the cost of telegrams or telephone calls.

Instead of deducting the actual cost of your meals when you are traveling away from home on business, you may be able to deduct either $14 or $9 a day for meals if you do not have to provide proof to your employer for the actual amount of your meal expenses. See *Standard meal allowance* under *Travel Expenses*, earlier.

Related to your employer. If you are related to your employer, you cannot take advantage of the fixed per diem allowance or reimbursement rule of having accounted to your employer or the standard meal allowance. You must be prepared to prove any deductions you claim. You may use the standard mileage rate even if you are related to your employer. You are related to your employer if:

1) Your employer is your brother or sister, half-brother or half-sister, spouse, ancestor, or lineal descendant,
2) Your employer is a corporation in which you own directly or indirectly more than 10% in value of the outstanding stock, or
3) Certain fiduciary relationships exist involving grantors, trusts, beneficiaries, etc.

To determine whether you own, directly or indirectly, any of the outstanding stock of a corporation, the following rules apply.

Rule 1. Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries.

Rule 2. A person is considered to own the stock owned, directly or indirectly, by or for his or her family. Family includes only his or her brothers and sisters and half-brothers and half-sisters, spouse, ancestors, and lineal descendants.

Rule 3. A person owning (other than by applying rule 2) any stock in a corporation is considered to own the stock owned directly or indirectly by or for a partner.

Rule 4. Stock constructively owned by a person under rule 1 for applying rules 1, 2, or 3 is treated as actually owned by that person. But stock constructively owned by a person under rules 2 or 3 is not treated as owned by that person for again applying either rule 2 or 3 to make another person the constructive owner of the stock.

If you accounted to your employer for your business expenses that you had solely for your employer's benefit, you need not include on your income tax return your expenses or the amounts you received as a reimbursement or other allowance if the reimbursement equals your expenses. If these reimbursements are more than your expenses, report the excess reimbursement on line 7 of Form 1040. If your expenses are more than your reimbursement, attach Form 2106 to your Form 1040. See *Partial Reimbursement*, earlier. Form 2106 is shown at the end of this publication.

If you are related to your employer, or if your expenses are more than your reimbursement and you deduct the excess expenses, you may be asked by the Internal Revenue Service to supply information about your expense accounts even if you accounted to your employer.

Example. You were sent by your employer to Boise for 10 days. You substantiated the time, place, and business purpose of your travel and your employer paid you $44 a day. This is all your employer reimbursed you during the year. While in Boise, you stayed at your brother's home and did not have any expense for food or lodging. While the receipt of $44 a day is regarded as an accounting to your employer, you must nevertheless report $440 ($44 × 10 days) as income because you did not have any expenses for food or lodging. Enter the $440 on line 7 of Form 1040.

If you did not account to your employer for expenses, attach Form 2106 to your Form 1040. To figure the amount to show on Form 2106, and the amount to deduct or include in income on Form 1040, include the total amount you received from or charged to your employer, including amounts charged directly or indirectly to your employer through credit cards or otherwise, and your expenses that were ordinary and necessary business expenses. See *Full Reimbursement* or *Partial Reimbursement*, earlier.

For expenses charged to your employer, use the actual amount on your Form 2106, even if your employer later received a discount on the amount charged. You must also keep records and supporting evidence to prove each element of an expense, as explained later under *Records*.

Outside salespersons do their selling away from their employer's place of business. If you are an outside salesperson, you do not have to itemize your deductions on Schedule A (Form 1040) to deduct all the allowable ordinary and necessary expenses you had in connection with your sales activities. You must reduce them by any reimbursements you receive from your employer that are not included on your Form W–2 as additional compensation. Except for meals, you may deduct these expenses even if you are not away from home. You may deduct the cost of meals only if you are traveling away from home or if the meals are allowed by the entertainment rules, discussed earlier.

If you are required to sell at your employer's place of business as a regular part of your work, even for only a specified period of time each week, you are not an outside salesperson.

If your main duties are service or delivery, you are not an outside salesperson. For example, bread truck drivers, milk truck drivers, and insurance debit agents are not outside salespersons.

You may have incidental activities at your employer's place of business, such as writing and sending orders or spending short periods using the telephone, and still qualify as an outside salesperson.

Records

You should keep the proof you need for travel, transportation, entertainment, and business gift expenses in an account book, diary, statement of expense, or similar record, supported by adequate documentary evidence, that together will support each element of an expense. For example, entries on a desk calendar, not supported by evidence, are not proper proof.

Note. The contemporaneous recordkeeping requirement was repealed before it ever took effect. You have to prove your deductions or credits for travel, entertainment, and business gift expenses by adequate records or by sufficient evidence corroborating your own statement. For tax years beginning after 1985, these rules also apply to prove your deduction for transportation expenses.

Also, for tax years beginning after 1985, these rules will not apply to certain vehicles that are not likely to be used more than a minimal amount for personal purposes. These vehicles include forklifts, cement mixers, dump trucks, refrigerated trucks, garbage trucks, tractors, combines, flatbed trucks, cranes, derricks, and school buses. Also, ambulances and hearses used as such, passenger buses used as such with a capacity of at least 20 passengers, qualified moving vans, qualified specialized utility repair trucks, clearly marked police and fire vehicles, delivery trucks with seating only for the driver or only for the driver plus a folding jump seat, a vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds, and certain uses of unmarked vehicles by law enforcement officers.

Written evidence has considerably more probative value than oral evidence alone. In addition, the probative value of written evidence is greater the closer in time it relates to the expense or use. A contemporaneous log is not required, but a record of the elements of an expense or of a business use made at or near the time of the expense or use, supported by sufficient documentary evidence, has a high degree of credibility not present with respect to a statement prepared later when generally there is a lack of accurate recall. Thus, the corroborative evidence required to support a statement not made at or near the time of the expense or use must have a high degree of probative value to elevate the statement and evidence to the level of credibility reflected by a record made at or near the time of the expense or use supported by sufficient documentary evidence. A log maintained on a weekly basis, which accounts for use during the week, is considered a record made at or near the time of the expense or use.

Duplicate information. You do not have to record information in your account book or other record that duplicates information shown on a receipt as long as your records and receipts complement each other in an orderly manner. You do not have to record amounts your employer pays directly for any ticket or other travel item. However, if you charge these items to your employer, through a credit card or otherwise, you must make a record of the amounts you spent.

Timely recordkeeping. Record the expense in your account book at or near the time of the expense. Entries made later, when there is a lack of accurate recall, do not comply with these rules.

Expense accounts. An expense account statement you give your employer, client, or customer is considered an adequate record of your expenses. The statement must be a copy of your account book or other record.

Chart showing proof required. The chart shown later sets forth in one place the factors in proving the elements of your expenses for travel, entertainment, and gifts.

To be able to deduct these expenses, you must prove the items listed in Column 1. You prove these items by having the information and receipts (where required) for the expenses listed in Column 2, 3, or 4, whichever is applicable.

Proving expenses. You may deduct travel expenses, including meals, lodging, and related items while away from home, or expenses for a type of activity generally considered entertainment, amusement, or recreation, or a facility used in connection with such activity, or for any expenses for gifts, only if you can prove certain items.

Deductions are not allowed for approximations or estimates, or for expenses that are lavish or extravagant.

Travel. You must prove:

1) Each separate amount you spent for travel away from home, such as the cost of your transportation or lodging. You may total the daily cost of your breakfast, lunch, dinner, and other incidental elements of such travel if they are listed in reasonable categories, such as meals, gas and oil, and taxi fares.
2) The dates you left and returned home for each trip, and the number of days spent on business away from home.
3) The destination or the locality of your travel, described by name of city, town, or similar designation.
4) The business reason for your travel or the business benefit gained or expected to be gained from your travel.

Entertainment. You must prove:

1) The amount of each separate expense for entertaining, except for incidental items, such as taxi fares and telephone calls, which may be totaled on a daily basis.
2) The date the entertainment took place.
3) The name, address or location, and the type of entertainment, such as dinner or theater, if the information is not apparent from the name or designation of the place.
4) The reason for the entertainment or the business benefit gained or expected to be gained from entertaining and, except for business meals, the nature of any business discussion or activity that took place.
5) The occupation or other information about the person or persons entertained, including name, title, or other designation sufficient to establish the business relationship to you.

Entertaining before or after business discussion. To deduct the cost of entertainment directly before or after a business discussion, you must be able:

a) To prove items (1), (2), (3), and (5) just listed under *Entertainment*, and
b) To prove the date, place, nature, and duration of the business discussion, and
c) To show the nature of the business discussion, and the business reason for the entertainment or the business benefit gained or expected to be gained from entertaining, and
d) To identify the people entertained who participated in the business discussion.

Season or series tickets. Treat each ticket in the series as a separate item and divide the cost of the season ticket accordingly. You must also keep records to show whether each ticket is used as a gift or entertainment.

Clubs. You may not deduct any part of the dues and fees you pay to a club unless you can prove you use the club more than 50% for entertaining to further your business or work. (See *Clubs* under *Entertainment Facilities*, earlier.) To show this, your records must prove all the elements of an expense for each use of the club you claim to be for your business or work.

Each time you use the club for nonbusiness purposes, include in your records the cost,

Elements to be proved (1)	For expenses for travel (2)	For expenses for entertainment (3)	For expenses for gifts (4)
Amount	Amount of each separate expense for transportation, lodging, and meals. Incidental expenses may be totaled in reasonable categories, such as gas and oil, taxis, daily meals for traveler, etc.	Amount of each separate expense. Incidental expenses such as taxis, telephones, etc., may be totaled on a daily basis.	Cost of gift.
Time	Date you left and returned for each trip, and number of days for business.	Date of entertainment or use of a facility for entertainment. For entertainment directly before or after a business discussion, the time spent discussing business.	Date of gift.
Place	Name of city or other designation.	Name and address or designation of place of entertainment, or place of use of a facility for entertainment. Type of entertainment if not otherwise apparent. Place where business discussion was held if entertainment is directly before or after a business discussion.	Not applicable.
Description	Not applicable.	Not applicable.	Description of gift.
Business purpose	Business reason for travel or nature of business benefit gained or expected to be gained.	Business reason or nature of business benefit gained or expected to be gained. Nature of business discussion or activity if entertainment is other than "business meals."	Business reason for making the gift or nature of business benefit gained or expected to be gained.
Business relationship	Not applicable.	Occupations or other information—such as names or other designations—about persons entertained that shows their business relationship to you. If all people entertained did not take part in business discussion, identify those who did.	Occupation or other information—such as name or other designation—about recipient that shows business relationship to you.

date, number of people entertained, and the nature of the entertainment. A notation, such as "personal use" or "family use," is enough to describe the nature of the entertainment.

If your records are not adequate, the club will be considered to be for your personal use. You will not be allowed a business deduction.

Gifts. You must prove:

1) The cost.
2) The date of the gift.
3) The description of the gift.
4) The reason for giving the gift or any business benefit gained or expected to be gained from giving it.
5) The occupation or other information about the person receiving the gift, including name, title, or other designation to establish the business relationship to you.

Transportation. For tax years beginning after 1985, you must prove:

1) The amount of each separate expense for a car or any other property used for transportation, such as the cost of buying a car, lease payments, the cost of maintenance and repairs, or other expenses.
2) The mileage, or other approved measure, for each business or investment use of the car or other means of transportation, and the total use.
3) The date of the expense or use.
4) The business reason for the expense or use of the car or other means of transportation.

Substantiation of business use. An adequate record contains sufficient information for each element of every business or investment use. The level of detail required to substantiate the use may vary depending on the facts and circumstances. For example, if your only business use of a truck is to make deliveries to customers on an established route, you may satisfy the requirement by recording the length of the delivery route once, the total miles you drove the truck during the tax year, and the date of each trip. Generally, an adequate record must be written. However, a record of the business use of a car prepared in a computer memory device with the aid of a logging program will constitute an adequate record.

Uses which may be considered part of a single use, such as a round trip or uninterrupted business use, may be accounted for by a single record. For example, use of a truck to make deliveries at several different locations which begins and ends at the business premises and which may include a stop at the business premises between two deliveries may be accounted for by a single record of miles driven. In addition, use of a car by a salesperson for a business trip away from home over a period of time may be accounted for by a single record of miles traveled. Minimal personal use, such as a stop for lunch on the way between two business stops, is not an interruption of business use.

Sampling. You may maintain an adequate record for parts of a tax year and use that record to substantiate the amount of business or investment use for the tax year if you can demonstrate by other evidence that the periods for which an adequate record is maintained are representative of the use throughout the tax year.

Example. You are a sole proprietor and a calendar year taxpayer. You operate a decorating business out of your home. You use a car for local business transportation to visit the homes or offices of clients, to meet with suppliers and other subcontractors, and to pick up and deliver items to clients. There is no other business use of the car, but you and other members of your family use the car for personal purposes. You maintain adequate records during the first week of each month which indicate that 75% of the use of the car is for business. The invoices from your business indicate that your business continued at the same rate during the subsequent weeks of each month so that your weekly records are representative of each month's business use of the car. Therefore, the determination that the business use of the car for the tax year is 75% is based on sufficient corroborative records.

Separating expenses. Each separate payment usually is considered a separate expense. If you entertain a customer or client at dinner and then go to the theater, the dinner expense and the cost of the theater tickets are separate expenses. You must record them separately in your records.

Some items may be totaled in reasonable categories. You may make one daily entry for such categories as taxi fares, telephone calls, meals while traveling away from home, gas and oil, and other incidental travel costs. You may include tips with the costs of the services you received. You are not required to total the tips. You may record them separately if you want.

Other items should be totaled. Expenses of a similar nature occurring during the course of a single event will be considered a single expense. Therefore, if during entertainment at a cocktail lounge you pay separately for each serving of refreshments, the total expense for the refreshments is treated as a single expense.

A receipt is ordinarily the best evidence to prove the amount of an expense.

Documentary evidence is required to support all lodging expenses while traveling away from home. It is also required for any other expense of $25 or more, except that if evidence is not readily available for transportation charges, it is not required.

Adequate evidence. Documentary evidence ordinarily will be considered adequate if it shows the amount, date, place, and essential character of the expense. For example, a hotel receipt is enough to support expenses for business travel if it has the name and location of the hotel, the dates you stayed there, and separate amounts for charges such as lodging, meals, and telephone. A restaurant receipt is enough to show an expense for a business meal if it has the name and location of the restaurant and the date and amount of the expense, and if a charge is made for items other than meals and beverages, the receipt must show that this is the case.

Cancelled check. A cancelled check, together with a bill from the payee, ordinarily establishes the cost. However, a cancelled check does not by itself support a business expense without other evidence to show that it was for a business purpose.

Business purpose. A written statement of the business purpose of an expense generally is required. However, the degree of proof varies according to the circumstances in each case. If the business purpose of an expense is clear from the surrounding circumstances, a written explanation is not required.

Example. A sales representative who calls on customers on an established sales route does not have to submit a written explanation of the business purpose for traveling that route.

Certain business meals. A written explanation of business purpose is not required if the business relationship between you and the recipient is evident. You must provide the food and beverages under circumstances considered conducive to a business discussion.

Business relationship. If you entertain a large number of people, you do not have to record each name of a readily identifiable group of people. It is enough to designate the class. For example, if you entertain all stockholders of a small corporation, an entry such as "all stockholders of the Acme Corporation" is enough. However, if the identity of a class is not enough to identify the persons entertained, then each person must be listed.

The name of the recipient of a business gift does not always have to be recorded. A general listing will be enough if it is evident that you are not trying to avoid the $25 annual limit on the amount you can deduct for gifts to any one person. For example, if you buy a large number of tickets to local high school basketball games and give one or two tickets to each of a number of customers, it is usually enough to record a general description of the recipients.

Confidential information relating to an element of a deductible expense, such as the place, business purpose, or business relationship, need not be put in your account book, diary, or other record. However, the information has to be recorded elsewhere at or near the time of the expense and be available to fully prove that element of the expense.

Incomplete records. If you prove the total cost of travel or entertainment but you cannot prove how much it cost for each person, you must divide the cost among your guests if a determination is necessary.

If you do not have adequate records to support an element of an expense, then you must prove the element by:

1) Your own statement, whether written or oral, containing specific information in detail as to the element, and
2) Other supporting evidence sufficient to establish the element.

If the element is the description of a gift, or the cost, time, place, or date of an expense, there must be direct evidence, such as a written statement or the oral testimony of your guests or a witness detailing information about the element or documentary evidence. If the element is either the business relationship of your guests or the business purpose of the amount spent, the evidence may be circumstantial.

Exceptional circumstances. Other evidence may be allowed if because of the inherent nature of the situation in which an expense is made, you cannot get a receipt.

For tax years beginning after 1985, if you establish that, by reason of the inherent nature of the situation:

1) You were unable to obtain evidence for an element of the expense or use tht conforms fully to the adequate records requirements,
2) You are unable to obtain evidence for an element that conforms fully to the other sufficient evidence requirements, and
3) You have presented other evidence for the element that possesses the highest degree of probative value possible under the circumstances,

this other evidence is considered to satisfy the substantiation requirements.

Destroyed receipts. You may prove an expense by reconstructing your expenses if you cannot produce a receipt for reasons beyond your control, such as fire, flood, or other casualty.

The Internal Revenue Service may require additional information to clarify or to establish the accuracy or reliability of information contained in your records, statements, testimony, or documentary evidence before a deduction is allowed.

Keeping records and receipts. You must keep proof to support your claim to a deduction as long as your income tax return can be exam-

ined. Generally, it will be necessary for you to keep your records for 3 years from the date of filing your income tax return on which you claimed the deduction. A return filed early is considered as filed on the due date.

Employees who give their records and documentation to their employers and are reimbursed for their expenses do not have to keep duplicate copies of this information. However, employees who claim deductions for expenses that are more than reimbursements, certain related shareholder-employees, and employees whose employers do not use adequate accounting procedures to verify expense accounts may be required to prove their expenses.

Examples

The following examples show the information you need to keep and how to report your expenses on Form 2106.

Example 1. You are a vice president of Zave Mfg. Corp. and you live in Chicago, where the home office of the company is located. On March 26, you travel by airplane from Chicago to Dallas, where you inspect a company plant. You return to Chicago the evening of March 27. During the stay in Dallas, you entertain Charles Young, the purchasing agent of the Sharpe Co., a prospective customer of the company. You prepare the following statement of expenses:

Travel Expenses:

Trip to Dallas to inspect Dallas plant

Date	Item	Amount
March 26	Air fare, round trip	$330.00
	Lunch & tip	12.00
	Lodging	66.00
March 27	Meals & tip	35.50
	Auto rental, 2 days	46.00
	Tips	6.50

Entertainment Expenses:

Date	Item/Place	Amount
March 26	Dinner & tip/Ajax Grill, Dallas	$ 62.50

Purpose/Relationship
Discussed purchase contract with C. Young, Purchasing Agent for Sharpe Co.

You have receipts for your expenses for lodging, air travel, auto rental, and entertainment. If Zave Mfg. Corp. requires a statement of expenses with the receipts, and it verifies and keeps the record and receipts, Zave may be considered as proving the expenses for which it reimburses you. You ordinarily will not be required to prove this expense account information again.

Example 2. You are an architect and have submitted plans to the Modern Real Estate Investment Trust for an apartment building that the Trust wanted to build. To discuss and promote these plans you invite the president of the Trust to lunch. You prepare, at or near the time of your expense, the following statement of expenses:

Entertainment Expenses:

Apr. 2—Lunch and tip ($24.00); Cafe Plaza, Rome, N.Y., with president of Modern R.E. Investment Trust concerning plans for Claremont Village Apts.

You do not have to get a receipt from the Cafe Plaza because the amount is less than $25.

Example 3. You are the president of Yates Corp. and you have a business discussion with three officers of Acme Corp. Afterward, all of you go to the Flair Nightclub where you pay $24 for drinks at the bar, including tip. All then go to the dining room where you pay $98 for dinner, plus tip. You prepare the following statement of expenses:

Entertainment Expenses:

Jan. 7—Taxi and tip ($8.55); Drinks at bar and tip ($24), dinner ($98) and tip ($20) at Flair Club, Wash., D.C.; Entertainment of the pres., v. pres., and treas. of the Acme Corp., following our business meeting at my office all afternoon re distributorship arrangements between Yates and Acme Corps.

You should get a receipt for the dinner bill because it is more than $25. If Yates Corp. requires a statement of expenses and it verifies and keeps the record, then the Yates Corp. may be considered as proving the expenses for which it reimburses you. You ordinarily will not be required to substantiate this expense account information again.

Example 4. You are a self-employed building equipment supplier and you have a family membership in a country club that you use frequently to entertain business customers. The club sends monthly bills to you for all charges at the club. To take a deduction for the club membership dues you must establish that you used the club primarily for your business. You must keep records of the daily use of the club, the cost of using it, and other information to establish such use. Your record should show the following information:

Month of January:

Jan. 7—Lunch with J. Jones (Doe Constr. Co., Boston) re equip. rental contract for bldg. at 14 & H Sts., $38.45.

Jan. 9—Family use.

Jan. 11—Personal lunch.

Jan. 14—Lunch with Ed Filbert (Central Development Corp., Hartford) re bldg. at 37 & Q Sts., $45.35.

Jan. 18—Family use.

Jan. 21—Lunch—Robert Smith (Young Constr. Co., Boston) discussed bldg. at 20 & A Sts., $35.41.

Jan. 23—Personal use.

Jan. 24—Lunch—Jim Green (Roe Constr. Co., Quincy) to discuss equip. for bldg. at 20 & A Sts., $29.80.

To prove direct expenses relating to the entertainment of business guests, such as business meals, you should keep records of those expenses together with any required documentary evidence. You should also keep the monthly bills submitted by the club.

Example 5. Bill Wilson is an outside salesperson for Fashion Clothing Co., 2473 White Plains Ave., Bronx, NY, 10111. In a typical week Bill leaves his home on Long Island Monday morning and drives to Philadelphia to exhibit the Fashion line for 3 days to prospective customers. Then he drives to Wilmington to show X department store, an old customer, Fashion's new line of merchandise, and talks with Tom Brown, purchasing agent for the store, to discuss the new line. He takes John Smith of Y Co., Wilmington, out to dinner to discuss Y Co.'s buying Fashion's new line of clothing.

Bill uses the standard mileage rate for car expense purposes. He records his total mileage, business mileage, parking fees, and tolls for the year. Bill records his expenses and other pertinent information in his *Weekly Traveling Expense and Entertainment Record*, shown later. He obtains receipts for his expenses for lodging and for any other expenses of $25 or more.

During the year Bill drove a total of 25,000 miles of which 20,000 miles were for business. He paid $400 for parking fees and tolls while using his car for business and $350 interest on his car. He may deduct $680 in addition to the car expense he arrived at using the standard mileage rate. This includes $400 for parking fees and tolls and $280 ($350 × 80%) for interest. In addition, he paid $12,632 for meals, lodging, and related items (laundry, cleaning, etc.) while on sales trips away from home and $5,870 for entertainment and other expenses. He received no expense allowance or reimbursement.

Bill files Form 2106, *Employee Business Expenses*, with his tax return. This form is shown at the end of this publication.

THIS IS NOT AN OFFICIAL INTERNAL REVENUE FORM

Weekly Traveling Expense and Entertainment Record

From: AUGUST 4, 19 85 To AUGUST 10, 19 85

Name: BILL WILSON

Expenses	Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Total
1. Travel Expenses: Airlines								
Excess baggage								
Bus - Train								
Cab and Limousine								
Tips								
Porter								
2. Meals and Lodging: Breakfast			2 75	3 00	3 25	3 00		12 00
Lunch		4 75	5 00	4 25	5 25	4 50		23 75
Dinner		8 00	9 25	7 50				24 75
Hotel and Motel (Detail in Schedule B)		50 00	50 00	50 00	45 00			195 00
3. Entertainment (Detail in Schedule C)					50 00			50 00
4. Other Expenses: Postage								
Telephone & Telegraph		1 50				1 00		2 50
Stationery & Printing								
Stenographer								
Sample Room			15 00	15 00				30 00
Advertising								
Assistant(s) & Model(s)			20 00	20 00				40 00
Trade Shows								
5. Car Expenses (List all car expenses - the division between business and personal expenses may be made at the end of the year) (Detail mileage in Schedule A)								
Gas, oil, lube, wash								
Repairs, parts								
Tires, supplies								
Parking fees, tolls		4 00			3 00	3 00		10 00
6. Other (Identify)								
Total		68 25	102 00	99 75	106 50	11 50		388 00

→ Note: Attach receipted bills for (1) ALL lodging and (2) any other expenses of $25.00 or more.

Schedule A - Car

Mileage: End		47,600	47,620	47,650	47,750	47,900	
Start		47,500	47,600	47,620	47,650	47,750	
Total		100	20	30	100	150	400
Business Mileage		100	20	30	100	120	370

Schedule B - Lodging

Hotel or Motel								
Name		BAY HOTEL	BAY HOTEL	BAY HOTEL	MODERN MOTEL			
City		PHILA.	PHILA.	PHILA.	WILMINGTON			

Schedule C - Entertainment

Date	Item	Place	Amount	Business Purpose	Business Relationship
AUG. 8, 1986		JOHN'S STEAK HOUSE WILMINGTON	BAR- $15.00 DINNER- $35.00	DISCUSS PURCHASES	SMITH - Y CO.

WEEKLY REIMBURSEMENTS:

Travel and transportation expenses ... _____

Other reimbursements ... _____

TOTAL ... _____

Form **2106**

Department of the Treasury Internal Revenue Service

Employee Business Expenses

▶ See instructions on back.

▶ Attach to Form 1040.

OMB No. 1545-0139

1985

54

Your name: BILL WILSON

Social security number: 000 00 0000

Occupation in which expenses were incurred: OUTSIDE SALESPERSON

Part I Employee Business Expenses Deductible in Figuring Adjusted Gross Income

1 Vehicle expenses from Part II, lines 15 or 22	1	3,700
2 Parking fees, tolls, and certain other expenses (see instructions)	2	680
3 Local transportation including train, cabs, bus, airplane, etc.	3	
4 Travel expenses while away from home overnight including meals, lodging, airplane, car rental, taxi, etc.	4	12,632
5 **Employees who are not outside salespersons:** Enter your expenses, not included on lines 1 through 4, for entertainment, gifts, and other business expenses, up to the amount you were reimbursed by your employer. Use Schedule A (Form 1040) for these expenses that were more than your reimbursement	5	
6 **Outside salesperson's expenses:** Enter your total expenses for entertainment, gifts, and other business expenses not included on lines 1 through 4	6	5,870
7 Add lines 1 through 6	7	22,882
8 Enter reimbursements from employer on this line if the reimbursements were not included on Form W-2	8	-0-
9 If line 7 is more than line 8, enter difference here and on Form 1040, line 25	9	22,882
10 If line 8 is more than line 7, enter difference here and include it on Form 1040, line 7	10	

Part II Vehicle Expenses (Use either your actual expenses or the standard mileage rate.)

Section A.—General Information

		Vehicle 1	Vehicle 2
1 Enter the date vehicle was placed in service	1	6 / 1 / 83	/ /
2 Total mileage vehicle was used during 1985	2	25,000 miles	miles
3 Miles included on line 2 that vehicle was used for business	3	20,000 miles	miles
4 Percent of business use (divide line 3 by line 2)	4	80 %	%
5 Average daily round trip commuting distance	5	-0- miles	miles
6 Miles included on line 2 that vehicle was used for commuting	6	-0- miles	miles
7 Other personal mileage (subtract line 6 plus line 3 from line 2)	7	5,000 miles	miles

8 Do you (or your spouse) have another vehicle available for personal purposes? ☒ Yes ☐ No

9 If your employer provided you with a vehicle, is personal use during off duty hours permitted? ☐ Yes ☐ No ☒ Not applicable

10 Do you have evidence to support your deduction? ☒ Yes ☐ No. If yes, is the evidence written? ☒ Yes ☐ No

Section B.—Standard Mileage Rate (Do not use this section unless you own the vehicle)

11 Enter the smaller of Part II, line 3 or 15,000 miles	11	15,000 miles
12 Subtract line 11 from Part II, line 3	12	5,000 miles
13 Multiply line 11 by 21¢ (.21) (see instructions for a fully depreciated vehicle)	13	3,150
14 Multiply line 12 by 11¢ (.11)	14	550
15 Add lines 13 and 14. Enter total here and on Part I, line 1	15	3,700

Section C.—Actual Expenses

		Vehicle 1	Vehicle 2
16 Gasoline, oil, repairs, vehicle insurance, etc.	16		
17 Vehicle rentals	17		
18 Value of employer-provided vehicle (applies only if included on Form W-2 at 100% fair rental value, see instructions)	18		
19 Add lines 16 through 18	19		
20 Multiply line 19 by the percentage on Part II, line 4	20		
21 Depreciation from Section D, column (f) (see instructions)	21		
22 Add lines 20 and 21. Enter total here and on Part I, line 1	22		

Section D.—Depreciation of Vehicles (Depreciation can only be claimed for a vehicle you own. If a vehicle is used 50 percent or less in a trade or business, the Section 179 deduction is not allowed and depreciation must be taken using the straight line method. For other limitations, see instructions.)

	Cost or other basis (a)	Basis for depreciation (Business use only—see instructions) (b)	Method of figuring depreciation (c)	Depreciation deduction (d)	Section 179 expense (e)	Total (column (d) + column (e)) (f)
Vehicle 1						
Vehicle 2						

For Paperwork Reduction Act Notice, see instructions.

Form **2106** (1985)

Table I

Dollar Amounts for Years 1 – 3
Cars Leased After April 2, 1985

Fair Market Value		Quarter of the Tax Year			
		4th	3rd	2nd	1st
Over	Not Over				
$11,250	$11,500	$ 8	$ 7	$ 6	$ 6
11,500	11,750	24	21	19	17
11,750	12,000	40	35	32	29
12,000	12,250	56	49	44	40
12,250	12,500	72	64	57	52
12,500	12,750	88	78	70	63
12,750	13,000	104	92	83	75
13,000	13,250	120	106	95	86
13,250	13,500	144	128	115	104
13,500	13,750	172	153	137	124
13,750	14,000	200	177	159	145
14,000	14,250	228	202	182	165
14,250	14,500	256	227	204	185
14,500	14,750	284	252	226	206
14,750	15,000	312	277	249	226
15,000	15,250	340	302	271	246
15,250	15,500	369	327	293	266
15,500	15,750	397	352	316	287
15,750	16,000	425	377	338	307
16,000	16,250	453	402	360	327
16,250	16,500	481	426	383	348
16,500	16,750	509	451	405	368
16,750	17,000	537	476	428	388
17,000	17,500	579	514	461	419
17,500	18,000	635	563	506	459
18,000	18,500	691	613	550	500
18,500	19,000	748	663	595	541
19,000	19,500	804	713	640	581
19,500	20,000	860	763	685	622
20,000	20,500	916	812	729	662
20,500	21,000	972	862	774	703
21,000	21,500	1,028	912	819	744
21,500	22,000	1,084	962	863	784
22,000	23,000	1,169	1,036	930	845
23,000	24,000	1,281	1,136	1,020	926
24,000	25,000	1,393	1,236	1,109	1,007
25,000	26,000	1,506	1,335	1,199	1,089
26,000	27,000	1,618	1,435	1,288	1,170
27,000	28,000	1,730	1,534	1,377	1,251
28,000	29,000	1,842	1,634	1,467	1,332
29,000	30,000	1,955	1,734	1,556	1,413
30,000	31,000	2,067	1,833	1,646	1,495
31,000	32,000	2,179	1,933	1,735	1,576
32,000	33,000	2,292	2,032	1,824	1,657
33,000	34,000	2,404	2,132	1,914	1,738
34,000	35,000	2,516	2,232	2,003	1,819
35,000	36,000	2,629	2,331	2,093	1,901
36,000	37,000	2,741	2,431	2,182	1,982
37,000	38,000	2,853	2,530	2,271	2,063
38,000	39,000	2,965	2,630	2,361	2,144
39,000	40,000	3,078	2,730	2,450	2,225
40,000	41,000	3,190	2,829	2,540	2,307
41,000	42,000	3,302	2,929	2,629	2,388
42,000	43,000	3,415	3,028	2,718	2,469
43,000	44,000	3,527	3,128	2,808	2,550
44,000	45,000	3,639	3,228	2,897	2,631
45,000	46,000	3,752	3,327	2,987	2,713
46,000	47,000	3,864	3,427	3,076	2,794
47,000	48,000	3,976	3,526	3,165	2,875
48,000	49,000	4,088	3,626	3,255	2,956
49,000	50,000	4,201	3,726	3,344	3,037

Table II — Dollar Amounts for Years 4 – 6 Cars Leased After April 2, 1985

Fair Market Value		Year		
		4	5	6
Over	Not Over			
$18,000	$18,500	$ 15	—	—
18,500	19,000	45	—	—
19,000	19,500	75	—	—
19,500	20,000	105	—	—
20,000	20,500	135	—	—
20,500	21,000	165	—	—
21,000	21,500	195	—	—
21,500	22,000	225	—	—
22,000	23,000	270	—	—
23,000	24,000	330	$ 42	—
24,000	25,000	390	102	—
25,000	26,000	450	162	—
26,000	27,000	510	222	—
27,000	28,000	570	282	—
28,000	29,000	630	342	$ 54
29,000	30,000	690	402	114
30,000	31,000	750	462	174
31,000	32,000	810	522	234
32,000	33,000	870	582	294
33,000	34,000	930	642	354
34,000	35,000	990	702	414
35,000	36,000	1,050	762	474
36,000	37,000	1,110	822	534
37,000	38,000	1,170	882	594
38,000	39,000	1,230	942	654
39,000	40,000	1,290	1,002	714
40,000	41,000	1,350	1,062	774
41,000	42,000	1,410	1,122	834
42,000	43,000	1,470	1,182	894
43,000	44,000	1,530	1,242	954
44,000	45,000	1,590	1,302	1,014
45,000	46,000	1,650	1,362	1,074
46,000	47,000	1,710	1,422	1,134
47,000	48,000	1,770	1,482	1,194
48,000	49,000	1,830	1,542	1,254
49,000	50,000	1,890	1,602	1,314

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